S. HRG. 98-1123

THE MALT BEVERAGE INTERBRAND COMPETITION ACT

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST AND SECOND SESSION

ON

S. 1680

A BILL TO CLARIFY THE CIRCUMSTANCES UNDER WHICH TERRITORIAL PROVISIONS IN LICENSES TO DISTRIBUTE AND SELL TRADEMARKED MALT BEVERAGE PRODUCTS ARE LAWFUL UNDER THE ANTITRUST LAWS

NOVEMBER 7, 1983 AND MAY 22, 1984

Serial No. J-98-78

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE
28-889 O WASHINGTON : 1984

5521-20

COMMITTEE ON THE JUDICIARY

STROM THURMOND, South Carolina, *Chairman*

CHARLES McC. MATHIAS, JR., Maryland
PAUL LAXALT, Nevada
ORRIN G. HATCH, Utah
ROBERT DOLE, Kansas
ALAN K. SIMPSON, Wyoming
JOHN P. EAST, North Carolina
CHARLES E. GRASSLEY, Iowa
JEREMIAH DENTON, Alabama
ARLEN SPECTER, Pennsylvania

JOSEPH R. BIDEN, JR., Delaware
EDWARD M. KENNEDY, Massachusetts
ROBERT C. BYRD, West Virginia
HOWARD M. METZENBAUM, Ohio
DENNIS DECONCINI, Arizona
PATRICK J. LEAHY, Vermont
MAX BAUCUS, Montana
HOWELL HEFLIN, Alabama

VINTON DEVANE LIDE, *Chief Counsel and Staff Director*
DEBORAH K. OWEN, *General Counsel*
SHIRLEY J. FANNING, *Chief Clerk*
MARK H. GITENSTEIN, *Minority Chief Counsel*

CONTENTS

OPENING STATEMENTS

	Page
Simpson, Hon. Alan K. (acting chairman)	1
Goldwater, Hon. Barry (prepared statement)	3
Thurmond, Hon. Strom (chairman)	123
DeConcini, Hon. Dennis (prepared statement)	123

PROPOSED LEGISLATION

Text of S. 1680—A bill to clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws 8

CHRONOLOGICAL LIST OF WITNESSES

MONDAY, NOVEMBER 7, 1983

Baxter, Hon. William F., Assistant Attorney General, Antitrust Division, Department of Justice 11

Winslow, Hon. Walter T., Deputy Director, Bureau of Competition, Federal Trade Commission 25

Panel consisting of: Ernest Gellhorn, a dean and Galen J. Roush Professor of Law, Case Western Reserve University, Cleveland, Ohio; Dr. Steve L. Barsby, Steve L. Barsby & Associates, Inc., Falls Church, VA; and Dr. W. John Jordan, associate professor of economics, Seton Hall University, South Orange, NJ 43

Panel consisting of: William Young, president, General Wholesale Beer Co., Atlanta, GA; Richard M. Quinn, sales manager, The Beer Co., Hartford City, IN; and Richard B. Willett, Alexander Grant & Co., Washington, DC 84

TUESDAY, MAY 22, 1984

Panel consisting of: R. Roy Pearce, chairman, Budweiser of Columbia, Greenville, Anderson, and Spartanburg, Columbia, SC, on behalf of the National Beer Wholesalers' Association, Inc., and Hon. E.W. Cromartie II, Columbia, SC, on behalf of the National Beer Wholesalers' Association, Inc., accompanied by L.L. Price, president, Budweiser of Columbia, Inc 125

Panel consisting of: James Reid Boylston III, Reid's Red and White, Barnwell, SC, on behalf of the Food Marketing Institute, and Matthew Protos, director and past president, National Licensed Beverage Association, Rockville, MD 142

Panel consisting of: Jay Angoff, Esq., public citizen, Washington, DC, and David I. Greenberg, Esq., legislative director, Consumer Federation of America, Washington, DC 179

ALPHABETICAL LISTING AND MATERIALS SUBMITTED

Angoff, Jay: Testimony 179

Barsby, Steve L.:
- Testimony 54
- Prepared statement 57

Baxter, Hon. William F.:
- Testimony 11
- Prepared statement 14

Page

Boylston, James Reid, III:
Testimony 142
Prepared statement 149
Cromartie, E.W., II:
Testimony 131
Prepared statement 133
Gellhorn, Ernest:
Testimony 43
Prepared statement 45
Greenberg, David I.:
Testimony 182
Prepared statement 185
Jordan, W. John:
Testimony 75
Prepared statement 77
Pearce, R. Roy:
Testimony 125
Prepared statement 127
Price, L.L.: Testimony 136
Protos, Matthew:
Testimony 164
Prepared statement 168
Miller Brewing Co. memorandum, opposing bill 172
United States Brewers Association, Inc. memorandum, opposing bill 174
"The 'New NBWA' or . . . Hot Air Over Falls Church," editorial in Modern Brewery Age, November 19, 1982 176
"Baltimore Revisited," editorial in Modern Brewery Age, January 31, 1983 177
"Passage of Interbrand Uncertain," Modern Brewery Age, May 7, 1984 178
Quinn, Richard M.:
Testimony 100
Prepared statement 102
Thurmond, Hon. Strom: Letter from Donald B. Shea, United States Brewers Association, Inc., May 22, 1984 193
Willett, Richard B.:
Testimony 106
Prepared statement 109
Winslow, Hon. Walter T.:
Testimony 25
Prepared statement 28
Letters from James C. Miller III, Chairman, FTC, dated June 11, 1982, expressing opposition to legislation 35
Young, William:
Testimony 84
Prepared statement 87

APPENDIX

Additional views from:
Texas Alcoholic Beverage Commission 195
National Grocers Association 197
State of New York, Department of Law 198, 202
City of New York, Department of Consumer Affairs 203
National Conference of State Liquor Administrators 205
Resolution 207
State of New Jersey, Department of Law and Public Safety 208
Hearing 209

THE MALT BEVERAGE INTERBRAND COMPETITION ACT—S. 1680

MONDAY, NOVEMBER 7, 1983

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 11:09 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Alan K. Simpson presiding.

Staff present: Steve Cannon, chief antitrust counsel; Sally Rogers, senior counsel; Joseph Gibson, committee staff; Boyd Hollingsworth, Senator Simpson's staff.

OPENING STATEMENT OF SENATOR ALAN K. SIMPSON

Senator SIMPSON. The hearing will come to order.

I welcome you to today's hearing. The committee is honored to have a fine and capable list of witnesses today. The subject of today's hearing is S. 1680, the Malt Beverage Interbrand Competition Act, introduced by our good friend Senator Barry Goldwater of Arizona.

This measure certainly has generated an interest. It has 28 cosponsors and I believe is quite identical to S. 1215, introduced in the last Congress by Senators Proxmire and Kasten.

I would note that this committee held hearings on S. 1215, and on June 21 and August 5, 1982, and I assisted in that. And I do that in order that all might be on notice that there is a wealth of material relevant to our continuing consideration of this issue available in the committee's records of those past 2 days of hearings.

Let me just say a word about our procedure here today. I apologize in advance to those who have been inconvenienced by the rescheduling of today's hearing from 10 o'clock to 11 o'clock and to those who may find their opportunity for their oral presentation to be somewhat shortened by our need to proceed in some haste this morning.

I just learned of this Friday and had to reschedule myself to do this. And I do not mind doing that as a cosponsor. I am pleased to do it. But, boy, I have a lot of stuff left over by doing it.

So we must do this, and I ask you to observe the time constraint to accommodate the various demands on all of our time this morning. I can assure you the distinguished chairman of the Judiciary Committee, Strom Thurmond, had fully intended to be present and

in the chair for this hearing, and unfortunately unexpected conflicts prevent him from being with us.

I know also that other members of the Judiciary Committee who are cosponsors, Senators Mathias, DeConcini, Biden, Baucus, and Grassley, would wish to be here as well. So I am here as a sub for those colleagues of mine. What you see is what you get in this situation. [Laughter.]

So, in order to proceed as expeditiously as possible, I would ask you to adhere to a 5-minute rule, and we will observe this grotesque device here which blows up after 5 minutes.

Each of your prepared statements have been received and will be placed in the record. I would ask you to present only a summary of your statement. It may well become necessary for me to leave. I think I can get it all in. I hope so. And if that is the case, then a staff member, professional staff will take the remainder of the testimony. I do not like to do that. I promise you it is repugnant to me. I dislike it, but if it becomes necessary, then I want to make that apology now to the remaining witnesses. But the staff of Senator Thurmond is most competent.

So, without taking more time, I have the statement of Senator Goldwater. That will be inserted in the record without objection.

[The prepared statement of Senator Goldwater and the text of S. 1860 follow:]

Prepared Statement of Hon. Barry Goldwater, a U.S. Senator from the State of Arizona

Mr. Chairman: I would like to thank you for calling this hearing on the proposed Malt Beverage Interbrand Competition Act (S. 1680).

As you are aware, I introduced S. 1680 on July 26 of this year. This legislation is necessary to help preserve state authority over the existing and highly competitive distribution system for beer in the United States. This is the distribution system under which the price of beer has increased far less than the increase in the cost of the great majority of goods on the Consumer Price Index. It is also a system which decades of experience has proved to be most effective for the states in controlling the distribution and sale of alcoholic beverages and the equitable and efficient collection of state excise taxes on beer sales.

Mr. Chairman, I believe it is incumbent upon the Congress to take this necessary step to preserve this system. The relationship among the brewers, the wholesalers, and retail outlets of all sizes has worked for more than 51 years. Mr. Chairman, the system works, and I see no reason why it would not continue to work.

Mr. Chairman, I think you will concur that it is the distribution system that we will rely upon in the years ahead to assure responsible and orderly marketing of an alcoholic beverage.

Mr. Chairman, already more than 25 of my colleagues have joined in pushing for this legislation in order to keep this proven system sound, and numerous members of the House of Representatives have co-sponsored the companion legislation in that body.

The Malt Beverage Interbrand Competition Act would simply preserve the legality under the antitrust laws of exclusive territorial agreements between breweries of beer and the wholesale distributors for those breweries' particular brands of beer.

It would do so by stating that these traditional brewery-wholesaler agreements are not by definition a violation of the antitrust laws.

This would codify for the beer industry the prevailing Supreme Court case law on this question. In Continental TV against GTE Sylvania in 1977, the Court held, speaking generally for all products, that a territorial agreement between a manufacturer and wholesaler is not a per se antitrust violation.

The same decision held that competition is best served by promoting vigorous interbrand competition among differing brands of the same product. The Court also found that territorial agreements may be necessary for a wholesaler to risk a substantial capital investment, to hire the required number of employees, advertise and promote the product, guarantee quality control and to meet the commitment to serve all potential retailers of the product. All of those conditions are particularly applicable to the beer industry.

Codification of this principle into law for the beer industry is necessary, Mr. Chairman, to avoid unnecessary litigation. Congress embodied this same principle for the soft drink bottling and distribution industry in the Soft Drink Interbrand Competition Act of 1980.

The Malt Beverage Interbrand Competition Act would not exempt wholesale beer distributors from any provisions of the antitrust laws. It would not eliminate any wholesale or retail outlets for beer now available in any state.

Twenty-two states, including South Carolina, Georgia, Ohio, Kansas, Vermont, and Michigan, now mandate by state law the assignment by breweries of exclusive territories to wholesale distributors of beer within those states. All other states permit the territorial agreements, except Indiana, which prohibits them by administrative ruling. My bill would not supersede or change any laws or regulations of any state, including Indiana.

Mr. Chairman, the legislators who drafted the 21st Amendment designated a system wherein the states control their own destinies with regard to the distribution and consumption of alcoholic beverages. This crucial state authority coexists with federal antitrust laws. Twenty-two states have concluded that exclusive franchises for beer distribution works. It serves their goals of strong competition and strict control in the market place.

It is therefore important for the Congress to clarify the federal position on exclusive territories to make it consistent with the 21st Amendment, and to declare that exclusive territorial agreements are not per se violations of the federal antitrust laws. This would also relieve the nation's beer wholesalers, independent small businessmen, of unnecessary and expensive lawsuits. In states which mandate territorial distribution of beer, these suits actually are challenges to state control over alcoholic beverages, as provided in the 21st Amendment. This legislation would reassert the states' rights under the 21st Amendment while saving the courts and private citizen's considerable time and money.

Enactment of this legislation would help reduce the uncertainty as to the proper application of the Sherman Act to territorial agreements, and reduce the likelihood of the type of chaotic litigation which can result. This act would provide clear guidelines for the courts, both state and federal, in interpreting the Sherman Act. Without some clarification there will be continuing confusion as there is in California, between the interpretation of the law by the state and federal court.

The alternative to territorial agreements for the wholesale distribution of beer is transshipping, which is a polite term for a legalized form of beer bootlegging.

Mr. Chairman, beer is an alcoholic beverage. As such, it must be distributed with more controls than such products as bread, soap or Twinkees.

Ever since enactment of the 21st Amendment to the Constitution, which repealed Prohibition, the states have required a

three-tier distribution system for beer. The three tiers are: brewery, wholesale distributor and retail outlet.

The existing wholesale distribution system comprises 4500 beer wholesalers--independent small businesses serving all licensed retail sellers of beer: large, medium and small. The average local wholesaler carries one or two major brands of beer in addition to a few lesser selling brands. These wholesalers compete to increase the sales and market shares for their respective brands. Thus there is stiff competition among local wholesalers and their brands. This interbrand competition insures competitive prices to the consumers.

Under the present system, the local wholesaler is required by his contract with the brewery to service all accounts, whether they buy one case or 1,000. Mr. Chairman, desruction of this system would hurt the small, "Mom and Pop" merchants. Transhippers service only the most profitable, high-volume accounts, putting the local wholesalers out of business. When the local wholesaler closes shop,the traditional, independent, "Mom & Pop" stores are left "out in the cold." This would give the largest chain stores monopoly control over the retail sale of beer.

In a letter from the Vermont Retail Grocers' Association to Sen. Stafford, the grocers pledged their support of Senate bill 1680 noting that exclusive territories "have been standard practice in the beer industry for many years and have benefited [Vermont] retailers in terms of low prices and quality products." These grocers said that this bill will "help maintain the present high level of good clean competition in the beer retail sales in the State of Vermont."

Mr. Chairman, the local wholesaler's responsibilities do not stop at delivery. The wholesaler's driver-salespersons must check for any stale beer or damaged product on the retailers shelves and replace it at the wholesaler's cost. The wholesaler is also responsible for the maintenance and cleanliness of beer taps and coils.

In contrast, wherever transshipping of beer flourishes, freshness of product and quality of service diminish. Without the wholesaler accountability associated with exclusive territories, no brewer is able to guarantee that the beer consumed is his best; without that, both the brewer and the consumer suffer.

Finally, Mr. Chairman, I would point out that the territorial system for the wholesale distribution of beer best enables the states to exercise the necessary control in this period of increased concern over the abuse of alcoholic beverages, specifically as it is reflected in the carnage upon our highways.

The National Conference of State Liquor Administrators endorsed the Malt Beverage Interbrand Competition Act. In a resolution passed June 23, 1983, the conference said strong forces are at work in the market place to break down their regulatory powers, which were granted by the laws of their respective states. The Act, the Conference states, "will greatly strengthen the ability of state liquor administrators to effectively discharge their responsibilities for controlling malt beverages...and promote more effective collection of...malt beverage excise taxes."

Mr. Chairman, the consumer is best served by a proven system of state regulated, wholesale distribution of beer. It makes a wide variety of the freshest product readily available through all types of retail outlets at highly competitive prices. The public in general is best served by a system which allows state regulators to easily monitor, record and control the distribution and sale of beer within state boundaries. That is the traditional wholesale beer distribution system in the United States. That is the system which is proven. That is the system that works. That is the system the Malt Beverage Interbrand Competition Act seeks to preserve.

Mr. Chairman, I again want to thank you for scheduling these hearings.

II

98TH CONGRESS
1ST SESSION

S. 1680

To clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws.

IN THE SENATE OF THE UNITED STATES

JULY 26 (legislative day, JULY 25), 1983

Mr. GOLDWATER introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Malt Beverage Interbrand Competition Act".

SEC. 2. Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any written contract entered into after the effective date of this Act by any brewer, importer, trademark owner, or trademark licensee of a trademarked malt beverage with any wholesale

distributor of provisions granting the wholesale distributor the sole and exclusive right to distribute and to sell such product in any defined geographic area within any State and limiting such exclusive distributor to the distribution and sale, directly or indirectly, of such product only for ultimate resale to consumers within that defined geographic area when such product is in substantial and effective competition with other malt beverage products within that defined geographic area.

SEC. 3. Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 of this Act in any written contract described in that section by means of price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints, or boycotts would otherwise be unlawful.

SEC. 4. As used in this Act the term "antitrust law" means the Act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (Sherman Act), approved July 2, 1890, the Federal Trade Commission Act, approved September 26, 1914, and the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (Clayton Act), approved October 15, 1914, and all amendments to such Acts.

SEC. 5. As used in this Act "malt beverage" shall mean and include beer of all types and varieties as defined in any Federal or State statute, ale, porter, stout, and all other simi-

larly designated fermented beverages containing one-half of 1 per centum or more alcohol by volume.

SEC. 6. As used in this Act the term "State" includes the District of Columbia and any territory or possession of the United States.

SEC. 7. This Act shall not invalidate or affect any provision of the laws of any State.

○

Senator SIMPSON. And our first witness this morning is William Baxter, Assistant Attorney General in charge of the Antitrust Division of the Department of Justice. It is always nice to see you, Bill; we appreciate having your views, please.

STATEMENT OF HON. WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. BAXTER. Thank you very much, Mr. Chairman. In view of the fact that the written statement we have submitted will be included in the record, I will try to be as brief as possible in summarizing our views.

As we did last year with respect to a virtually identical measure, the Department of Justice opposes the enactment of S. 1680. As I am sure the chairman knows, it is our general view that vertical arrangements of the general type dealt with by this legislation are, at worst, benign and often very helpful to productivity, cost reduction, and should not generally be discouraged.

On the other hand, those arrangements can, under certain circumstances, be troublesome. And the circumstances of the beer industry present a very, very fine example of precisely the circumstances under which vertical arrangements can serve to facilitate horizontal collusion.

I do not mean to suggest that there are not the kinds of free rider problems present in the beer industry that would, in other industrial circumstances, justify the use of exclusive territories, which is what is contemplated by this bill; there are problems about refrigeration of the beer and other problems that might very well call for the use of exclusive wholesalers.

But the circumstances of the industry are those which should make us very wary about enacting this bill. The brewery industry itself is relatively concentrated. But the wholesale distribution, a local activity, is even more highly concentrated, and the pattern of several breweries appointing the same wholesaler to be their exclusive distributor gives rise to very, very high concentrations and very high risk of horizontal collusion at the wholesaling level.

It is important to emphasize that the dangers of potential horizontal collusion are not protected against by section 3 of this bill. Section 3 is limited in its scope to activities associated with the enforcement of the contract provisions. It provides that nothing in this act shall be construed to legalize the enforcement of the contract provisions by means of price-fixing agreements, horizontal restraints, or group boycotts.

The concerns about anticompetitive horizontal effects have nothing to do with the enforcement of the contract provisions, and so the savings clause in section 3 is totally irrelevant to the problems about which I am concerned.

It is the present law, of course, that exclusive territorial arrangements are not unlawful, per se; they are to be tested under the rule of reason. I sympathize with the people in the industry who would like to see some more clarity in the present status of the law. There is no doubt that there is uncertainty in many instances about whether these arrangements are permissible.

But if there is to be clarification, we think it should be clarification of a generic type that would apply to the whole rule of reason area and to all industries. The rule of reason could use a good deal of clarification. But we think that special interest legislation aimed at specific industries is very unwise. Not only would it make lawful, per se, as an operational matter these exclusive arrangements in an industry whose circumstances are about as troublesome as could be imagined, but it probably would tip the courts to treat even more harshly—since Congress did not choose to legalize the situation for them—vertical arrangements in other industries where they actually should be regarded more favorably.

Just a word, if I could, Mr. Chairman, on what I mean by the characteristics of the industry. I have already referred to the phenomenon of concentration, very small numbers of participants at the wholesaling level. That alone would not raise problems as serious as those that are raised here. What really makes the situation very unfortunate is that there are statutory entry barriers to being a wholesaler in most States.

It is freedom of entry into the distribution system that generally assures that vertical arrangements cannot be employed for anticompetitive purposes. And, of course, there is no assurance of that here. On the contrary, the State laws would interact with S. 1680 in a way that would create a very high probability of horizontal collusion. And it is for those reasons that the Department opposes enactment of this measure.

Thank you, Mr. Chairman.

Senator SIMPSON. Thank you very much, Bill Baxter.

Could you suggest or recommend any language that would guard against the danger of horizontal collusion?

Mr. BAXTER. It is very difficult to do so in a phrase; I must say I have not set myself to that task, and I do not want to say that some language could not be found. But certainly, the ingredients of such an approach would be referenced to the number of present participants at the wholesale level and to the existence of freedom of entry at the wholesale level.

Just by way of an example of what troubles me, in most industries a new entrant at the manufacturing level, who faced a situation where there were only two or three distributors through whom he could distribute his product and who were already dealing with others, could set up his own wholesale network and encourage a new distributor to come into existence. Or perhaps, through vertical integration he could perform his own distribution.

But almost all of our States have statutory prohibitions against a distiller or a brewer performing the wholesale activity. There are very, very rigid licensing requirements so that you have these rigid entry barriers at the wholesale level. And, certainly, brewers should not be able to use exclusive territories in the presence of that kind of entry barrier, in combination with high degrees of concentration at the wholesaler level.

Senator SIMPSON. Would you be more favorably disposed toward this type of legislation if it were an attempt at a broad clarification rather than specifically directed at one industry?

Mr. BAXTER. Yes, I would, very much. I mean, I would be delighted to work with the Judiciary Committee to attempt to achieve a

general clarification not only of the rule of reason, but the whole process of analysis under the rule of reason.

I think that kind of clarification on a generic basis would be very helpful and, certainly, in such an endeavor exclusive territorial arrangements is one of the problems one would wish to address.

Senator SIMPSON. But you definitely feel that this bill's requirement of "substantial and effective interbrand competition" does not provide the safeguards that you would ask?

Mr. BAXTER. No; I really do not think it does, Mr. Chairman. I mean, I do not know exactly what that language means or what the courts would do with it. The historical antecedent, of course, is the passage of the fair trade laws back in the thirties.

There, if I recall correctly, the phrase was if the goods are in "free and open competition," then state fair trade laws preempted the antitrust laws. Almost the first case out of the box dealt with Eastman Kodak film, a company that had something approaching 80 percent of the entire market. As I have not read that case in some years, Mr. Chairman, I may have my facts a little wrong, but I believe the court pronounced that was free and open competition.

Well, of course, that for all practical purposes was the end of that statutory phrase. So there really cannot be any assurance without further elaboration of what that phrase means.

Senator SIMPSON. Let me submit the balance of my statements in writing. Certainly we have, the problem of the special interest standard. Of course then we have alcoholic beverages historically being treated differently, and malt beverages would likely receive that treatment. Of course, the fact of that strict licensing and control is there, and it is alleged that protections are there. And we do not want to have something that is just going to go on into litigation from here, proving a negative and doing these other things.

So, I appreciate having your views, and they will be weighed, as will the others of the other witnesses. Thank you very much.

Mr. BAXTER. Thank you, Mr. Chairman.

[The prepared statement of Mr. Baxter follows:]

28-889 O - 84 - 2

Prepared Statement of William F. Baxter

Mr. Chairman and Members of the Committee:

I am pleased to appear this morning to present the views of the Department of Justice on S. 1680, the "Malt Beverage Interbrand Competition Act." This bill is identical to S. 1215, which was introduced during the last Congress, and which the Department opposed in testimony before, and in a written report submitted to, this Committee. We continue strongly to oppose such legislation and I am happy to have this opportunity to state our reasons for that position.

The bill's stated purpose is "[t]o clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws." Section 2 of the bill provides that nothing contained in any federal antitrust law shall render unlawful exclusive territorial agreements in any written contract between a wholesale distributor and any brewer, importer, trademark owner, or trademark licensee of a trademarked malt beverage, 1/ so long as the malt beverages covered by such agreements are in "substantial and effective competition with other malt beverage products within [a] defined geographic area." Section 3 provides that nothing in the bill shall be construed as legalizing enforcement of such exclusive territorial arrangements by means of "price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreements, restraints or boycotts would otherwise be unlawful."

One basis for our opposing enactment of this legislation is that the bill might be interpreted as creating a different standard for judging the legality of exclusive territorial arrangements in the malt beverage industry, a standard weaker than that articulated in Continental TV, Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), and currently applicable to most industries. A different, weaker standard for judging exclusive territorial arrangements in the malt beverage industry is

undesirable for two reasons. First, although exclusive territorial arrangements usually serve efficient purposes, the malt beverage industry is a good example of those very special circumstances in which widespread use of such arrangements might have anticompetitive effects. Second, and more important, as a general policy the Department opposes piecemeal, special-interest changes in antitrust standards of general applicability. To the extent that any clarification is required of the applicability of existing law to exclusive territorial arrangements, such clarification should be through judicial interpretation of existing antitrust statutes or through congressional enactment of broadly applicable standards regarding such arrangements.

I would emphasize that the Department recognizes that the use of exclusive territorial arrangements by manufacturers is usually motivated by legitimate purposes such as a desire to overcome free-rider effects among distributors (wholesalers). In many industries, distributor expenditure on product promotion, quality control (e.g., the refrigeration of beer while in storage), or point-of-sale services enhances the value and reputation of the product, leading to increased sales and intensified interbrand competition. If several distributors can sell a manufacturer's product in a given geographic market, they all benefit from its enhanced reputation and the associated increase in sales induced by the expenditures of any one distributor. That distributor, however, would capture only a fraction of the increased sales induced by its own expenditures. The result would be too little expenditure in the aggregate on product promotion, quality control, or point-of-sale services, since any one distributor would be reluctant to spend heavily so long as others were able to "free ride" by taking advantage of sales increases without contributing to the expenditures responsible for those increases. To encourage expenditures, a manufacturer may award

exclusive territories to its distributors--that is, assign a different geographic area to each distributor and permit only the designated distributor to sell in its assigned area. As a result, promotion, quality control, and point-of-sale services may increase, the reputation of the product may improve, and sales may increase. Thus, where exclusive territories are awarded to combat free-rider problems and improve the product's reputation, the economic effects are generally beneficial. 2/

The Department recognizes that exclusive territorial arrangements have beneficial effects in a wide range of market settings. Therefore, we view such arrangements as legitimate in most cases; they should be prohibited only where their effect may be substantially to weaken interbrand competition.

One way in which exclusive territories may weaken interbrand competition is by facilitating collusion among wholesalers. Widespread use of exclusive territories by all or most manufacturers may reduce substantially the total number of wholesalers competing in any geographic area. Since the likelihood of collusion increases when the number of firms in the market is reduced to a very small number, widespread use of exclusive territories may weaken interbrand competition by facilitating collusion among wholesalers of the different manufacturers.

It might be argued that manufacturers would not award exclusive territories for the purpose of facilitating wholesaler collusion, since such collusion increases wholesale prices and markups while reducing manufacturers' sales and profits. However, manufacturers might desire wholesaler collusion if they believed that they could share in the higher profits earned by colluding wholesalers. 3/ Furthermore, collusion may be easier at the wholesaler than at the manufacturer level. The number of wholesalers in any given area may be lower than the number of manufacturers because several manufacturers may appoint the same exclusive-territory wholesaler. In addition, enforcement

authorities may find wholesaler collusion more difficult to detect than manufacturer collusion because wholesaler collusion would probably take place on a more localized scale.

In many, if not most, industries, the structural characteristics of production and distribution significantly reduce the likelihood that exclusive territories will or can be used to generate anticompetitive results in the manner discussed above. For example, if wholesaler concentration remains low, even with widespread use of exclusive territories, the likelihood of effective collusion at that level also remains low. Even in those situations in which common use of exclusive territories creates high wholesaler concentration, the likelihood of successful collusion at that level is reduced if manufacturer concentration is low, 4/ or entry into manufacturing is easy. If the latter conditions prevail, some manufacturer--an established firm or a new entrant--would be strongly encouraged to exploit the opportunity for new sales created by the high prices and restricted availability of other manufacturers' products resulting from the wholesaler collusion. The distribution of such manufacturer's product may be accomplished by the manufacturer's creation of its own distributors (downstream vertical integration), by luring existing distributors away from the collusive scheme, or by inducing the entry of new distributors.

Unfortunately, none of the above mitigating factors is present in the malt beverage industry. Indeed, this industry appears to be one in which the risk that widespread use of exclusive territories may produce anticompetitive effects is almost uniquely high.

Regarding sales concentration, in 1982 the top two brewers had a combined national market share of 54 percent and the top four had 74.8 percent. 5/ These figures represent increases over the 1980 levels, which were 50 percent for the top two brewers and 67.1 percent for the top four. 6/ Brewer

concentration at the state level was often significantly higher than national concentration. For example, in 1982 the four-firm concentration ratio exceeded 80 percent in 28 of the 37 states for which data was available. 7/

The distribution system in the malt beverage industry translates high brewer concentration into high concentration at the wholesale level. We understand that virtually all brewers use exclusive territorial arrangements. Moreover, in many markets, different brewers utilize the same wholesaler. These factors result in concentration at the wholesale level that may exceed that at the brewer level. 8/ Further, a prospective entrant into brewing may encounter difficulties in establishing distribution channels. This is primarily due to state regulations that usually prohibit vertical integration by brewers into wholesaling and place licensing requirements on entry by independent wholesalers.

For these reasons, we believe that exclusive territories may raise competitive concerns in the malt beverage industry. Thus, it is important to preserve the ability to challenge exclusive territories where they facilitate collusion, whether in this or any other industry, while recognizing that in most cases exclusive territories serve desirable purposes. The present law gives us this flexibility while the proposed legislation, we fear, may not.

At present, the legality of exclusive territorial arrangements is determined under Section 1 of the Sherman Act. 9/ In applying that provision to such arrangements between suppliers and their distributors, courts utilize the "rule of reason" to ascertain whether, under all the circumstances, the particular arrangement is an unreasonable restraint of trade. 10/ This flexible and yet structured approach reflects appropriate judicial recognition of the fact that such arrangements, while not necessarily or even typically anticompetitive, may have anticompetitive effects, and may, in certain circumstances, require condemnation under Section 1.

Under the language of S. 1680, exclusive territorial arrangements would be deemed lawful so long as the product was in "substantial and effective competition" with other malt beverages within a defined geographic area. However, the term "substantial and effective competition" is not defined in the bill, and its meaning is unclear. In addition, it is not clear which party would have the burden of establishing the presence or lack of such competition, how it is to be measured, or how much "substantial and effective competition" is necessary in order to satisfy the requirements of the bill if significant anticompetitive effects were to be shown. Nor is it clear at what level or levels on the production and distribution chain "substantial and effective competition" must be present in order for the bill's standard to be applicable. Thus, because of the differences in language between Sherman Act Section 1 and S. 1680, a court might find that exclusive territorial arrangements were lawful under S. 1680 even where it would conclude that they unreasonably restrained competition under the rule of reason.

We understand that Section 3 is intended to make clear that Section 2 of the bill is not to be interpreted as authorizing enforcement of exclusive territorial agreements by means of "price-fixing agreements, horizontal restraints of trade, or group boycotts" that would otherwise be unlawful. We do not read Section 2 as permitting such a result, and we recognize that the antitrust laws would potentially be available to challenge actual collusion among competitors even if S. 1680 were enacted. However, it may be difficult to detect collusion at the wholesale level, especially where the number of firms in any geographic market is small or where they operate in localized markets. By the same token, there would also be difficulties in proving collusion, even where it exists.

Such difficulties could largely be avoided if the flexible and yet structured analysis of the present rule-of-reason

approach were retained. The fact that we could proceed against actual collusion where it is detected under the standards of the bill does not negate the need to be able to challenge exclusive territorial arrangements under the antitrust laws as currently interpreted in those circumstances where they act to facilitate collusion and thereby pose a significant threat to consumer welfare. Moreover, it is not the means of enforcement of such vertical arrangements that gives rise to our concern; it is the danger of collusion by wholesalers, facilitated by exclusive territorial arrangements. Thus, our opposition to S. 1680 is not lessened by Section 3.

Proponents of S. 1680 argue that it is necessary to clarify the law as to exclusive territorial arrangements in order to secure the economic benefits that such arrangements provide. However, brewers at present can and do enter into exclusive territorial arrangements with their wholesalers. The Supreme Court has expressly recognized that such arrangements may have beneficial effects, and has held that such arrangements are not unlawful unless they have unreasonable anticompetitive effects. Continental TV, Inc. v. GTE Sylvania, supra, at 58-59. Moreover, cases decided since GTE Sylvania have recognized the economic benefits that vertical territorial arrangements may provide. 11/ The present Administration has repeatedly declared its intention to avoid simplistic attacks on such arrangements where their procompetitive utility outweighs such anticompetitive risks as they might contain.

We therefore view S. 1680 as an unwarranted exception to the antitrust standards applied to most other industries. The antitrust laws embody the fundamental national policy of free market competition, and they are applicable to a variety of factual circumstances in virtually any industry. As the January 1979 Report of the President's National Commission for the Review of Antitrust Laws and Procedures concluded, Congress' reliance upon the antitrust laws to protect and promote

competition is abundantly justified, and exceptions from this general policy should only be made where there is "compelling evidence of the unworkability of competition or a clearly paramount social purpose." 12/ No such showing has been made with respect to the malt beverage industry, and we believe none could be made.

Most important, to the extent that genuine clarification of the antitrust laws governing exclusive territories may be desirable, it should proceed on a general basis and not through special-interest legislation. Legislative endorsement of exclusive territories in the malt beverage industry may be undesirable not only in and of itself, but also may also be construed to imply, incorrectly, that exclusive territorial provisions are less legitimate in industries not affected by this legislation. The same response is appropriate to arguments that passage of this bill would decrease the amount of litigation over, among other things, termination of distributors. We are not aware that there is more such litigation in the malt beverage industry than in others, and we believe that any reforms in this area should be made on an across-the-board basis for the same reason we believe any clarification of the law should be a general--not an industry-specific--one.

We recognize that the Soft Drink Interbrand Competition Act, 13/ enacted during the 96th Congress, is similar to S. 1680. The Department of Justice objected repeatedly and strenuously to passage of that Act, among other reasons, for fear that it might be interpreted as creating a standard of legality for vertical territorial arrangements in the soft drink industry different from that contained in Section 1 of the Sherman Act. Indeed, at least one court has indicated that it may be so interpreted; 14/ and enactment of S. 1680 poses the same risk.

Furthermore, introduction of S. 1680 confirms the validity

of our repeatedly expressed fears that passage of the Soft Drink Act would create an undesirable precedent for similar special interest legislation applicable to other industries. 15/ Legislative recognition of another special rule for a particular industry would cast further doubt on the universal applicability of the antitrust laws to the unregulated sectors of our economy and would invite even further attempts by other industries to seek special-interest legislation. Such a course could only lead to a patchwork of differing antitrust rules that would greatly complicate antitrust enforcement and deprive the antitrust laws of much of their utility. In recent years, Congress has increasingly narrowed existing antitrust immunities, and has relied more heavily upon competition, even in highly regulated industries. Such movement has been seen, for example, in the airline, trucking, rail, and intercity bus industries and is presently occurring in the telecommunications and financial institutions industries. Establishment of an antitrust standard for the malt beverage industry potentially different from that applicable to other industries would be inconsistent with this desirable trend.

Conclusion

In sum, the Department of Justice believes that enactment of S. 1680 would be unnecessary and unwise. The Department of Justice, the Supreme Court, and numerous lower courts have expressly recognized the benefits from exclusive territorial arrangements and the courts have repeatedly held that such arrangements are not unlawful unless they have unreasonable anticompetitive effects. S. 1680 might be held to legalize exclusive territorial arrangements even if they have substantial anticompetitive effects and would be held unlawful under proper application of the rule of reason.

There is simply no valid reason why the malt beverage industry should not continue to be subject to the same flexible and yet structured antitrust rule-of-reason analysis applicable

to most other industries. Indeed, passage of S. 1680 would further erode the general applicability and utility of the antitrust laws.

Accordingly, the Department of Justice strenuously opposes enactment of S. 1680.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions you or any members of the Committee may have.

END NOTES

1/ "Malt beverage" is defined in section 5 of the bill as "beer . . . ale, porter, stout, and all other similarly designated fermented beverages containing one-half of one percentum or more alcohol by volume."

2/ For a more detailed discussion of the free-rider phenomenon, see Posner, "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," 45 U. Chi. L. Rev. 1 (1977).

3/ Manufacturers might extract some of the profits of wholesaler collusion by raising wholesale prices, charging franchise or other fees, or imposing new obligations on wholesalers.

4/ Low concentration in manufacturing is consistent with high concentration in wholesaling if several manufacturers appoint the same wholesaler to be their sole distributor in a given territory.

5/ 1983 Modern Brewery Age Bluebook.

6/ See 1981 Modern Brewery Age Bluebook.

7/ The breakdown was as follows: In 5 of the states the four-firm concentration ratio exceeded 90 percent, in 28 it exceeded 80 percent, in 35 it exceeded 75 percent and in 37 it exceeded 65 percent. The identity of the four leading brewers differed in some states. These high state-level concentration figures are essentially unchanged from 1980 levels. See Steinman's Beer Statistics News, April 1981, March 1983.

We recognize, of course, that states do not necessarily correspond perfectly to economic markets. At the brewer level, economic markets probably are often comprised of several states. However, at the wholesale level, markets may often be no larger than an individual state because state regulations generally prohibit sales by out-of-state wholesalers, making the state an upper limit on the size of the market. It is at the wholesale level that concern about collusion is greatest in this context.

8/ While multiple brewer use of the same wholesaler would make concentration higher at the wholesaler than at the brewer level, a potentially offsetting factor is that territories awarded by different brewers may not overlap perfectly, increasing the number of wholesalers in any geographic market. In any event, wholesale concentration appears to be high.

9/ 15 U.S.C. § 1. The first sentence of Section 1 of the Sherman Act states: "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal."

10/ Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

11/ At least one appellate court has expressly recognized such benefits with respect to the malt beverage industry. In Del Rio Distributing, Inc. v. Adolph Coors Co., 589 F.2d 176 (5th Cir.), cert. denied, 444 U.S. 840 (1979), the Fifth Circuit Court of Appeals upheld a jury verdict that Coors' exclusive territorial restrictions were reasonable because there was ample evidence showing that the territories "were essential to maintaining quality control and service in the retail market" and resulted in "a long-term effect of making each distributorship stronger, better able to compete with other brands and provide better service." 589 F.2d at 179. For additional post-GTE Sylvania cases recognizing the beneficial effects of vertical territorial arrangements, see, e.g., Donald B. Rice Tire Co. v. Michelin Tire Corp., 638 F.2d 15, 16 (4th Cir. 1981), cert. denied, 454 U.S. 864 (1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1006 (5th Cir. 1981), cert. denied, 454 U.S. 827 (1981); Cowley v. Braden Industries, Inc., 613 F.2d 751, 755 (9th Cir. 1980), cert. denied, 446 U.S. 965 (1980); Abadir & Co. v. First Mississippi Corp., 651 F.2d 422, 426-28 (5th Cir. 1981); Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1200-1201 (6th Cir. 1982); Continental TV, Inc. v. GTE Sylvania, Inc., 694 F.2d 1132, 1136-39 (9th Cir. 1982); Newberry v. Washington Post Co., 438 F. Supp. 470, 475-76 (D.D.C. 1977).

12/ Id. at 177.

13/ 15 U.S.C. §§ 3501-03.

14/ Coca-Cola Co. v. FTC, 642 F.2d 1387 (D.C. Cir. 1981), on remand, 98 F.T.C. 445 (1981) (granting motion to dismiss complaints based on "superseded standards").

15/ We note that the Soft Drink Act was initially proposed in response to FTC proceedings against seven soft drink syrup manufacturers. When the FTC held, in 1978, that the territorial arrangements constituted unreasonable restraints of trade, the soft drink industry pressed its efforts to have that legislation enacted and argued that it was necessary to correct a misapplication of the rule of reason to vertical territorial arrangements as required by GTE Sylvania. No similar situation exists with regard to the malt beverage industry.

Senator SIMPSON. The next witness, please, the Honorable Walter Winslow, the Deputy Director of the Bureau of Competition of the Federal Trade Commission of Washington. Please, Mr. Winslow.

STATEMENT OF HON. WALTER T. WINSLOW, DEPUTY DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Mr. WINSLOW. Thank you, Senator Simpson. I appreciate this opportunity to present the views of the Federal Trade Commission concerning S. 1680. Attached to my prepared statement is a letter that the Commission sent last year to Senator Thurmond and Congressman Rodino, and I request that that letter as well as the prepared statement be contained in the committee's record.

Senator SIMPSON. Without objection.

Mr. WINSLOW. I will first read the Commission's four reasons for opposing this bill and then try to summarize the Commission's elaboration of those points.

First, the Commission fully supports Congress' traditional refusal to grant an industry special status under the antitrust laws unless and until the industry has presented compelling evidence of the unworkability of competition or of a clearly paramount social purpose. We submit that no showing has been made or could be made by the malt beverage industry so as to warrant special antitrust treatment.

Second, we believe that the currently applicable rule of reason standard best serves the legitimate interests of brewers and distributors, while maximizing consumer welfare, because the rule takes into account all relevant economic factors in determining the legality of vertical territorial restraints.

Third, the intent of S. 1680 is not clear on its face. It may be either a restatement of the standard currently applicable to the industry, in which case it would be unnecessary as well as confusing, or it may be a change in the applicable standard, presumably a change towards leniency, in which case it is likly to be not only confusing but injurious to consumers.

And, finally, the Commission believes that there are special factors, including existing Government barriers to entry, that make it especially important that exclusive territorial arrangements in the malt beverage industry be subject to full scrutiny under the rule of reason to determine their impact on competition and consumers.

Since the Commission's testimony is in some respects similar to that of the Department of Justice, which emphasized the Commission's first and fourth points, what I will try to do in my remaining time is to elaborate a bit on the second and third of the Commission's reasons for opposing the bill; that is, the adequacy of the rule of reason and the fact that any amendment of the rule of reason is going to end up injuring consumers.

When it is applied to vertical restraints, the rule of reason looks at the supplier's reasons for imposing the restriction and at the structure and dynamics of the particular industry and the markets involved. The goal is to determine whether the agreement is likely to enhance competition, efficiency, and consumer welfare by increasing output or is more likely to harm competition and consumers by reducing output. Only the rule of reason assures that all rel-

evant competitive factors will be considered and all extraneous factors ignored.

When the existing rule best serves consumers and competition, we can see no reason to introduce a new rule for the malt beverage industry. Since the *GTE Sylvania* case made it clear that a rule of reason standard apply to nonprice vertical restraints, the Commission and the courts have been clarifying exactly how one goes about doing that rule of reason analysis.

For example, the Commission's *Beltone* decision explains that an exclusive territorial arrangement is illegal only if it results in harm to interbrand competition. Such restrictions on intrabrand rivalry are perfectly legal if they do not cause an overall decrease in interbrand competition. The Commission concluded that the restrictions challenged in the *Beltone* case did not have the adverse interbrand effects necessary to violate the antitrust laws.

In view of the adequacy of the rule of reason, the Commission does not believe that any new statutory standard is necessary. Proponents of the bill, however, suggest that the new legislation is necessary if brewers are to be allowed to set up distribution systems that promote competition. And the principal argument I have heard is that territorial restrictions are necessary to prevent undesirable transshipments of the malt beverages. The Commission has not done a factual study on this issue, but the point is that if transshipment restrictions in fact enhance competition among different brands by assuring needed services such as rotation or avoiding consumer purchases of stale beer, then the rule of reason would not prevent the adoption of reasonable transshipment rules, including total bans in appropriate circumstances.

The rule of reason provides an established standard that works well. We submit, therefore, it would be a mistake to enact a new standard. The proposed standard is at best confusing and superfluous as a restatement of current law. And if the standard represents a change of current law, the change is likely to injure consumers.

The confusion comes from the lack of definition and the unclarity of the meaning of the term "substantial and effective competition." This is not a term familiar to courts, prosecutors, economists, or others. If the term is just a shorthand restatement of the rule of reason, then the bill should not be enacted because it is unnecessary and confusing. If it is more lenient, the question is what relevant economic facts are being eliminated from the calculus. Would the new standard ignore the existence of substantial barriers to entry, for example? Whatever relevent economic facts are made irrelevant, we can predict that the new standard will injure competition and consumers.

Senator SIMPSON. I thank you very much. It is interesting to note that the Assistant Attorney General is testifying that the current status of the rule of reason needs perhaps some broad clarification, and you are saying that it is best for the interest of consumers at this time.

Mr. WINSLOW. In its written testimony the Commission states that its position is not that the rule of reason is a magic wand which provides easy answers, but that it is a workable and flexible tool. In contrast we simply do not know what the term substantial and effective competition means.

Senator SIMPSON. You of course are saying that there is nothing threatening the industry now, but leaving that aside, whether that is not a relevant consideration for enactment of any legislation, is not the absence of a direct threat perhaps simply a matter of chance?

Would not the Indiana experience indicate that there is a substantial move against exclusive territories? Could it be that simply the current state of antitrust law is a potential threat of rather lengthy litigation? And maybe the existence of this legislation itself might be forestalling litigation?

How is that for a triple barrel shot?

Mr. WINSLOW. Rule of reason cases are complicated. There is no doubt about that. The reason that they are is that what the courts and the Commission attempt to do is to weigh all of the relevant evidence. Our concern is that unless substantial and effective competition is simply a restatement of the rule of reason—in which case we will be able to weigh all the relevant evidence, but cases will not be simplified—then what this legislation means is that some relevant economic factors are not going to be able to be looked at, in which case consumers will end up being injured.

Senator SIMPSON. Thank you very much. There will be further questions in writing. And thank you for your appearance here.

Mr. WINSLOW. Thank you.

[The prepared statement of Mr. Winslow follows:]

PREPARED STATEMENT OF WALTER T. WINSLOW

Mr. Chairman, I would like to thank you for this opportunity to present the views of the Federal Trade Commission concerning S. 1680, the Malt Beverage Interbrand Competition Act. Attached to this statement is a copy of the Commission's letter of June 11, 1982, to Senator Thurmond and Congressman Rodino setting forth in detail the Commission's opposition to an identical bill introduced last year. The Commission takes this opportunity to reaffirm the conclusions stated in that letter. I respectfully request that the Commission's letter be included in the Committee's record. I would be pleased to answer any questions following this statement.

S. 1680 would create a special antitrust standard for the malt beverage industry to use in testing the lawfulness of what are known as "airtight" vertical exclusive territorial agreements. In other industries, this sort of arrangement, in which a manufacturer permits only one distributor to sell its products to dealers in a geographic area, is analyzed under antitrust's rule of reason. This means that such agreements are currently legal except when they have demonstrable adverse effects on interbrand competition in the relevant market. Under the proposed legislation, however, exclusive territorial agreements would be exempt from the antitrust laws if a new standard—the existence of "substantial and effective" interbrand competition—is met.

There are four major reasons for the Commission's opposition to S. 1680. I will first list the reasons and then elaborate upon each of them for the Committee's consideration. First, the Commission fully supports Congress' traditional refusal to grant an industry special status under the antitrust laws unless and until the industry has presented compelling evidence of the unworkability of competition or of a clearly paramount social purpose. We submit that no such showing has been or could be made by the malt beverage industry so as to warrant special antitrust treatment. Second, we believe that the currently applicable rule of reason standard best serves the legitimate interests of brewers and distributors, while maximizing consumer welfare, because the rule takes into account all relevant economic factors in determining the legality of vertical territorial restraints. Third, the intent of S. 1680 is not clear on its face. It may be either a restatement of the standard already applicable to the industry, in which case it would be unnecessary as well as confusing, or a change in the applicable standard, in which case it is likely to harm consumers while also confusing the industry and the courts. And, finally, the Commission believes that there are special factors, including

existing government barriers to entry, that make it especially important that exclusive territorial agreements in the malt beverage industry be subject to full scrutiny under the rule of reason to determine their impact on competition and consumers.

We respectfully submit that the malt beverage industry has made no showing that would warrant special treatment under the antitrust laws through the creation of a unique standard of review applicable only to that industry. Special antitrust status has only been grudgingly granted by Congress and the courts. In recent years, as both the Commission and the Congress know all too well, numerous industry groups have sought such special status under the antitrust laws. Congress has repeatedly refused their requests, concluding that the nation is better served by application of the current standards of law, than by the passage of special exemptions, standards, or status for particular industries. As the National Commission for the Review of Antitrust Laws and Procedures aptly stated the last time Congress, the Executive, and the public took an in-depth look at these issues, special antitrust status should only be granted "where there is compelling evidence of the unworkability of competition or a clearly paramount social purpose."[1]

The Commission is unaware of any evidence establishing the need for this special antitrust status. We have seen no evidence suggesting that malt beverage wholesalers are different from wholesalers in other industries. They provide storage, refrigeration, and distribution services that are typical for wholesalers, especially in the food and beverage industries. Nor has the Commission seen anything to indicate that competition is unworkable in the malt beverage industry or that there is any overriding social policy that could be served by this legislation. The proponents of last year's predecessor of S. 1680 sought to justify this legislation with the claim that malt beverage wholesalers are caught between increasing concentration among brewers and increasing concentration among retailers. Even if this allegation were correct, however, it would not begin to establish that competition among wholesalers is unworkable or that exclusive territories would correct, rather than exacerbate, such defects in the marketplace.[2]

In the 97th Congress, proponents of the Malt Beverage Interbrand Competition Act also cited as a justification for the bill some uncertainty created by a California case that applied a per se standard to a vertical restraint in the liquor industries. The

United States Supreme Court has decided that case, however, and it reversed the decision of the California court in a way that eliminates any fears that the malt beverage industry might have had.[3] There simply appears to be nothing about this industry or the law as applied to it that would justify or warrant enacting a new legal standard applicable to territorial arrangements within the malt beverage industry.

Furthermore, the Commission believes that the rule of reason is the correct antitrust standard to apply to the territorial restrictions a manufacturer unilaterally imposes on its distributors. Under the rule of reason, all relevant economic factors are examined to determine whether a challenged restraint on balance injures competition—that is, whether its anticompetitive effects are outweighed by its procompetitive effects. Factors unrelated to competition are not allowed in this calculus. Only if it is established that a practice has a net anticompetitive effect is the practice unlawful.[4]

When applied to vertical territorial restraints, the rule of reason looks at the supplier's reasons for imposing the restriction, and at the structure and dynamics of the particular industry and markets involved. The goal is to determine whether the agreement is likely to enhance competition, efficiency and consumer welfare by increasing output, or is more likely to harm competition and consumers by reducing output. The Commission believes that the competitive effects of a vertical territorial restriction can only be understood after such a thorough economic examination. Only rule of reason scrutiny assures that all relevant competitive factors will be considered, and all extraneous factors ignored. Therefore, we believe that the rule of reason best serves the legitimate interests of suppliers and distributors—a desire to make their product as competitive as possible in the marketplace—while maximizing consumer welfare.

When the existing rule best serves consumers and competition, we can see no reason to introduce a new rule for the malt beverage industry. The confusion caused by use of a per se rule in the Schwinn case is gone.[5] In 1977 the Supreme Court made it clear that exclusive territorial arrangements are lawful unless they are proven to have anticompetitive effects that outweigh their procompetitive effects.[6] Indeed, the courts and the Commission have fleshed out and refined the Sylvania rule over the last six years, answering lingering questions about how a decision-maker should analyze the effect of vertical restraints on "intrabrand" and "interbrand" competition.

For example, the Commission's Beltone decision[7] explains that an exclusive territorial arrangement is illegal only if it results in harm to interbrand competition—such restrictions on intrabrand rivalry are perfectly legal if they do not cause an overall decrease in interbrand competition. The Commission concluded that the restrictions challenged in Beltone did not cause the interbrand effects necessary to violate the antitrust laws—complaint counsel had not shown that the restraints decreased competition in the market as a whole.

In upholding Beltone's distribution system, the Commission also explained that exclusive territorial arrangements may in some circumstances have adverse interbrand effects. The Commission identified the relevant competitive concerns,[8] and explained the factors that must be examined in analyzing the likely effects of such a restraint, including the structure, performance and dynamics of the industry, the seller's marketing strategy, and likely efficiencies to be gained from the restriction.[9] My point is not that Beltone presents a magical easy answer for every exclusive territorial agreement, but that the Commission and the courts have evolved a useful, flexible, and sophisticated set of tools for evaluating such restraints under the rule of reason. There is no reason to believe a new test could improve on the results from the point of view of competition or consumer welfare.

Proponents of the bill suggest, however, that the new legislation is needed if brewers are to be allowed to set up distribution systems that promote competition and efficiency. For example, the industry argues that legislation is needed so that they might restrict the undesirable transshipment of their product. However, if transshipment restrictions in fact enhance competition among different brands of beer by assuring needed services (e.g., stock rotation) or avoiding consumer purchases of stale beer, the rule of reason would not prevent the adoption of reasonable transshipment rules, including total bans in appropriate circumstances. Indeed, the Commission has modified a series of orders over the past year specifically to permit restrictions on transshipments meant to strengthen a seller's competitive position.[10] Unless territorial exclusives and/or transshipment restrictions have adverse interbrand effects, they are currently legal; and if they do have adverse interbrand effects, they should not be legal.

The rule of reason provides an established legal standard that serves competition and the public well. We submit, therefore, that it would be a mistake to enact the new

standard contained in S. 1680. The standard is at best a confusing and superfluous restatement of the current law. And if the standard represents a change in the law, it is likely to injure consumers.

Confusion arises for a number of reasons. First, the meaning of the proposed statutory standard—whether the product in question is "in substantial and effective competition with other malt beverage products"—is unclear. "Substantial and effective competition" is not a term that is familiar to courts, prosecutors, economists, or the industry. Is this just a shorthand restatement of the rule of reason? If so, "substantial and effective competition" would be that quantum of interbrand competition that prevents an intrabrand restriction from having a net anticompetitive effect on interbrand competition. If the new standard is merely meant to be a codification of the rule of reason, the bill should not be enacted because it is unnecessary, and its adoption would necessarily confuse industry members, antitrust litigants, and the judiciary, making it difficult to give antitrust guidance, and assuring protracted litigation. Beyond the uncertainty as to whether or not the new standard merely replicates the rule of reason, "substantial and effective" would end up having a different meaning in every case, depending on the nature of the intrabrand restriction(s) and on the peculiar facts of each market. Only lawyers and consultants would gain from such a situation.

If the new standard is somehow meant to be different from the rule of reason, the lack of definition or specificity would again cause great confusion. More important, though, any variation from the rule of reason is likely to reduce consumer welfare. The rule of reason takes into account all relevant competitive factors and only condemns an arrangement that is on balance anticompetitive. Which relevant economic factors would be left out under the new standard? Where would the new balance be drawn?

If the new standard is meant to be a change, Congress presumably intends to impose a less strict standard for this industry. The rule of reason focuses on whether the vertical restraint is likely to enhance competition and efficiency, and thereby increase output. Would the new, lenient standard ignore such factors as a potential decrease in output, a greater likelihood of collusion, or an increase in market power? Would "substantial and effective competition" between brands of beer presumptively exist wherever there are numerous brands available? Even if one wholesaler has the franchise on all major brands? Regardless of the existence of substantial barriers to entry?

Brewers and their chosen distributors may be pleased with a more lenient standard, but consumers and competition would surely be harmed, because a standard more lenient than the rule of reason would by definition permit some arrangements that are on balance anticompetitive.

Beyond its faith in the rule of reason, the Commission believes that the malt beverage industry is an especially inappropriate one to select for lenient treatment in the context of vertical distributional restraints. As noted above, breweries have a relatively high concentration level. Moreover, since state regulatory schemes typically create legal barriers restricting entry in the malt beverage industry, the enactment of S. 1680 might unacceptably reduce the opportunity for market forces to correct quickly any anticompetitive problems which may exist or develop in the industry. Several state laws, for instance, make it very expensive and very difficult—if not impossible—for brewers to terminate inefficient wholesalers. Together with exclusive territorial provisions, these state laws could prevent consumers from receiving the benefits of competition and efficiency.

This point highlights one of the differences between the malt beverage industry and the soft drink industry, for which Congress in 1980 enacted an exemption[11] that appears similar to the one proposed in S. 1680. While concentration in the soft drink industry is also relatively high, that industry does not have governmentally-imposed barriers to entry that could prevent marketplace solutions to competitive problems. In addition, while the malt beverage wholesalers typically have investments in warehouses and trucks, their investments are generally smaller than those of soft drink bottlers with their plants and equipment. Furthermore, malt beverage wholesalers do not participate in the production of malt beverages, whereas the soft drink bottlers do engage in production. Finally, there is no FTC decision or court decision which can be perceived as threatening the malt beverage industry. These considerations make it less appropriate to give the malt beverage industry special status under the antitrust laws.

In conclusion, the Commission is strongly opposed to the adoption of S. 1680. We are unaware of any evidence or principled argument that might justify the bill, and we believe that enactment of such unjustified special exemptions has the detrimental effect of undercutting the ability of antitrust enforcement to preserve this Nation's free market economy. Moreover, since the antitrust laws currently permit procompetitive exclusive

territorial arrangements, the only exclusive territorial arrangements that could be legalized by a weakening of current antitrust standards are those arrangements whose overall effect is anticompetitive. Finally, our view of competitive conditions in the malt beverage industry serves to reinforce our opposition to S. 1680, for the industry appears to be one in which it is particularly important to safeguard against the anticompetitive use of exclusive territorial arrangements.

Mr. Chairman, I hope you will find this testimony helpful to your deliberations. I would be pleased to answer the Committee's questions.

END NOTES

1 National Commission for the Review of Antitrust Laws and Procedures, Report to the President and the Attorney General 177 (1979). Proponents of S. 1680 argue that the bill is not an exemption, but this argument amounts to linguistic quibbling, because the bill would exempt the malt beverage industry from the usual antitrust prohibitions relating to exclusive territorial agreements.

2 Nationally, four-firm concentration in beer brewing has increased from 46% in 1970 to about 74% in 1981. On a state-by-state basis the median four-firm sales figure exceeds 80%. Concentration among retailers, both nationally and in regional areas, is very low.

3 Rice v. Norman Williams Co., 458 U.S. 654 (1982). Finding that a state "designation statute" authorized conduct that would be per se illegal under federal antitrust law, a California Court of Appeal had held the statute invalid on its face. The U.S. Supreme Court reversed and remanded on the ground that the statute authorized conduct which might be found legal under the correct antitrust analysis, i.e., under a rule of reason test. The decision should enable malt beverage wholesalers to rely on permissive state laws and a rule of reason analysis.

4 National Society of Prof. Eng'rs v. United States, 435 U.S. 679 (1979). The rule of reason standard permits consideration of factors which are unique to a particular industry, and it permits justifications that relate not merely to price competition, but also to competition based on quality and convenience. It does not recognize, however, arguments that competition would be harmful in a particular market. Id. at 689-90.

5 United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967).

6 Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

7 Beltone Electronics Corp., 100 F.T.C. 68 (1982).

8

> In considering the negative impact on interbrand competition in this context, it is important to clarify that what we are concerned about are horizontal effects at either the manufacturer or dealer level. These effects can be manifested in several ways: a) as actual collusion among competitors which increases prices and restricts output; b) as an increased likelihood of anticompetitive interdependent behavior or oligopolistic pricing which yields results similar to collusion; or c) as enhancement or creation of market power on the part of one or more sellers.

Id. at 206-07.

9 Id. at 206-09.

10 E.g., Magnavox Co., D. 8822 (July 13, 1983); U.S. Pioneer Electronics Corp., C-2755 (Nov. 12, 1982); Lenox, Inc., D. 8718 (July 2, 1982).

11 The Soft Drink Interbrand Competition Act, 15 U.S.C. §§ 3501-03.

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

OFFICE OF THE CHAIRMAN

JUN 11 1982

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We appreciate the opportunity to respond to your recent request for the Federal Trade Commission's comments on S. 1215, the "Malt Beverage Interbrand Competition Act."

The Commission is strongly opposed to the enactment of S. 1215. We have just completed an analysis of H.R. 3269, the companion of S. 1215, and to expedite our response to your request we are enclosing copy of a letter to Chairman Rodino which explains the grounds for our opposition to this legislation in some detail.

In sum, we have concluded that this proposal is an unjustified special exemption from the antitrust laws, and that such proposals undercut the effectiveness of antitrust enforcement to preserve the free market economy. Moreover, since the agreements covered by the bill are currently permitted so long as they are procompetitive, the only possible effect of weakening the current antitrust standard would be to legalize arrangements that are predominately and demonstrably anticompetitive.

By direction of the Commission.

signed and hand-delivered

James C. Miller III
Chairman

Enclosures

FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

OFFICE OF THE CHAIRMAN

JUN 11 1982

Honorable Peter W. Rodino, Jr.
Chairman
Committee on the Judiciary
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter responds to your request for the Federal Trade Commission's views on H.R. 3269 (the "Malt Beverage Interbrand Competition Act"), a bill that would create an antitrust exemption for certain exclusive territorial arrangements in the malt beverage industry. We have analyzed both the bill and the background material you sent us setting forth the position taken by supporters of the bill.

The Commission strongly opposes enactment of H.R. 3269 for two reasons. First, the bill is an unjustified special exemption from the antitrust laws for a single industry. As is discussed below, exemptions from the antitrust laws should not be granted unless there is clear evidence that enforcement of the antitrust laws in a particular situation would cause undesirable results. We are not aware of any such evidence concerning exclusive territorial arrangements in the malt beverage industry. Second, enactment of H.R. 3269 will not help either competition or consumers and may well injure both competition and consumers. Any procompetitive arrangements the exemption seeks to protect are currently permitted under well established principles of antitrust law. On the other hand, H.R. 3269's new and ambiguous standards are likely to create uncertainty, and -- more important -- the sole effect of weakening the current antitrust standards regarding exclusive territorial arrangements would be to legalize those arrangements that are predominately and demonstrably anticompetitive.

After a brief description of H.R. 3269, we explain the basis for our opposition to the bill. We believe that the reasons why enactment of the bill would not be in the public interest are apparent without the necessity of substantial analysis either of the nature of exclusive territorial arrangements or of competitive conditions in the malt beverage industry. Nonetheless, after explaining our reasons for opposing H.R. 3269, we set forth a more extensive analysis of these and other factors that may be useful to the Committee as background for considering this bill.

Description of H.R. 3269

The operative provision of H.R. 3269 is Section 2:

> "Sec. 2. Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any written contract entered into after the effective date of this Act by any brewer, importer, trademark owner, or trademark licensee of a trademarked malt

> beverage with any wholesale distributor of provisions granting the wholesale distributor the sole and exclusive right to distribute and to sell such product in any defined geographic area within any State and limiting such exclusive distributor to the distribution and sale, directly or indirectly, of such product only for ultimate resale to consumers within that defined geographic area when such product is in substantial and effective competition with other malt beverage products within that defined geographic area."

The thrust of H.R. 3269 is to create an antitrust exemption allowing brewers and wholesalers to enter contracts defining the exclusive territory to be served by each wholesaler of a given brewer, provided that within each such territory there is "substantial and effective" competition with other malt beverage products. Section 3 of the bill recites that the bill is not intended to legalize the enforcement of exclusive territories "by means of price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints or boycotts would otherwise be unlawful." Section 5 of the bill defines "malt beverage" to include beer, ale, porter, and other fermented beverages containing one half of one percent or more alcohol by volume.1/

Special Antitrust Exemptions

In assessing proposed antitrust exemptions, it is important to recognize that the antitrust laws reflect the Nation's fundamental policy in favor of free enterprise and competition. Moreover, the antitrust laws are sufficiently flexible to take into account the different competitive conditions that prevail in different industries. For these reasons, exemptions from the antitrust laws are extremely difficult to justify. In this regard the Commission endorses the analysis and conclusions contained in the Report of the President's National Commission for the Review of Antitrust Laws and Procedures (1979), which declared (at p. 177) that antitrust exemptions are justifiable only where there is "compelling evidence of the unworkability of competition or a clearly paramount social purpose." The proffered justifications for an exemption presented by supporters of H.R. 3269 fall far short of this standard; therefore, the bill should not be enacted.

The only evidence presented by supporters of H.R. 3269 concerning competitive conditions in the malt beverage industry consists of statistics tending to show that malt beverage wholesalers stand between two increasingly concentrated groups -- the brewers and the retailers.2/ Based on these statistics, it is claimed that the bill will maintain competition among wholesalers. Whether or not these statistics present an accurate picture of the malt beverage industry,3/ this claim does not appear to have any merit. We fail to see how exclusive territories in wholesaling could in any way offset any possible detrimental effects of an increase in concentration in brewing and/or retailing. (Moreover, as noted below, the antitrust laws already permit exclusive territorial arrangements to be used except in those situations where they have anticompetitive effects.) In short, we are not aware of even any colorable argument that the proposed exemption would remedy any defect in the marketplace and thereby promote either competition or other social goals.

In these circumstances, the antitrust laws should apply to the distributors of malt beverages in the same way that they apply to most of the rest of the Nation's economy. We believe that the antitrust laws deal with exclusive territories in a sound manner, but if the Congress desires to analyze this question, it should do so on a general rather than a special interest basis. Like the Soft Drink Interbrand Competition Act (15 U.S.C. §§3501-03) on which it is patterned, H.R. 3269 is an unjustified special exemption of the sort that erodes the role of antitrust enforcement as a guarantor of the efficient operation of our free market economy, and the bill is inconsistent with recent actions and current proposals toward deregulation of the marketplace. In sum, H.R. 3269 should not be adopted because there is no principled basis for the antitrust exemption it would create.

Likely Effects of H.R. 3269

The second basis for our opposition to H.R. 3269 is that the bill will not help competition or consumers and may well injure competition and injure consumers. Exclusive territorial arrangements are frequently procompetitive but can sometimes be anticompetitive. Enactment of H.R. 3269 would apparently have the perverse effect of protecting exclusive territories that are anticompetive while not promoting exclusive territories that are procompetitive.

Under current law, exclusive territorial arrangements such as those covered by H.R. 3269 are lawful unless they have anticompetitive effects that outweigh their procompetitive effects. As stated by the United States Supreme Court in Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), exclusive territorial arrangements restrict "intrabrand competition" but can promote "interbrand competition" and thus be procompetitive on balance. We elaborate on these points below, but for purposes of explaining our opposition to H.R. 3269 it is sufficient to reiterate that exclusive territorial arrangements are sometimes anticompetitive and to emphasize that such arrangements are judged on a rule-of-reason basis. As a result, exclusive territorial arrangements are currently legal except in those circumstances in which it is proved that their overall effect is anticompetitive.

Under H.R. 3269, however, the antitrust laws would be inapplicable to an exclusive territorial arrangement in the malt beverage industry whenever the products covered by the arrangement are in "substantial and effective competition" with other malt beverage products. It is not clear what this statutory language is intended to mean,4/ but it is evident to us that any weakening of the antitrust standard of legality would be undesirable. Since antitrust law currently outlaws only those arrangements that are anticompetitive, the only exclusive territorial arrangements that could be legalized by H.R. 3269 are those that are predominately and demonstrably anticompetitive.5/

Moreover, we do not believe that enactment of H.R. 3269 would promote those exclusive territorial arrangements that are procompetitive. In this regard, we disagree with assertions made by supporters of H.R. 3269 that the bill will have the beneficial effect of reducing uncertainty about legal requirements or reducing the costs of litigation.6/ At present, the legality of exclusive territorial arrangements is tested by well established legal and economic principles, and H.R. 3269 would introduce new and ambiguous criteria that would have to be applied by both firms in the industry and by courts and the Commission. The

result of such a change is likely to be increased uncertainty and increased costs of litigation, and the bill will therefore not promote -- and may even discourage -- the establishment of procompetitive exclusive territorial arrangements.

In sum, H.R. 3269 should not be enacted because it will not help either competition or consumers, and it may well injure both competition and consumers.

Supplemental Analysis of Exclusive Territorial Arrangements in the Malt Beverage Industry

As noted above, analysis of the likely effects of H.R. 3269 does not require any substantial discussion either of exclusive territorial arrangements or of competitive conditions in the malt beverage industry. Nonetheless, we are including such a discussion as background for the Committee. The discussion serves to emphasize the lack of justification for H.R. 3269.

We begin by emphasizing that exclusive territorial arrangements can be procompetitive in that they can be used by a manufacturer to avoid problems that sometimes arise if its distributors directly compete among themselves. For example, a manufacturer may want its distributors to take steps to preserve product quality or to provide promotional or other services. For some products, distributors' expenditures on such activity can enhance demand, promote interbrand competition, and in general contribute to the product's overall success. If the manufacturer's distributors compete among themselves, however, each distributor may seek to avoid making these procompetitive expenditures and to profit from whatever increased sales are generated by the expeditures of its competitors. In other words, each distributor may seek to take a "free ride" on its competitors' expenditures, in which case procompetitive services may ultimately not be provided.

When a manufacturer is concerned that its distributors may not voluntarily provide services because of a "free rider" problem, the manufacturer may respond in a variety of ways to ensure or encourage the provision of the services it desires. The manufacturer can ensure that the services will be provided by performing them itself or by contracting with distributors to perform the services. Alternatively, the manufacturer may seek to provide distributors with an increased incentive to perform the services by such means as assigning them areas of primary responsibility or exclusive territorial arrangements. By adopting these policies, the manufacturer restricts or eliminates intrabrand competition, and interbrand competition may thereby be increased because distributors protected by these policies may have a greater incentive to provide services since their expenditures will benefit them and not their competitors.

Although exclusive territories necessarily restrict intrabrand competition, they do not necessarily or even usually provide market power to distributors. As noted above, there are a variety of less restrictive means by which a manufacturer may be able to ensure that necessary services are provided, and the manufacturer would normally have an incentive to avoid granting exclusive territories in circumstances where the distributor would thereby be able to exercise market power. The existence of these alternatives and incentives provides some protection against the danger that the assignment of an exclusive territory will result in higher prices caused by a unilateral exercise of

market power by a distributor. Moreover, there is little risk that any of a manufacturers' distributors will be able to restrict distribution and raise prices if they all face vigorous competition from the distributors of competing producers.

There are, however, additional ways in which exclusive territorial arrangements can be anticompetitive. In particular, such arrangements can facilitate or reinforce collusion among competitors. For example, distributors may wish to enter into a horizontal market division agreement in which there will be only one distributor in each area. The purpose of this agreement is not efficiency in distribution, but the elimination of competition so that distributors can charge prices above the competitive level. Such an anticompetitive agreement among the distributors could be facilitated by exclusive territorial arrangements between manufacturers and distributors. In this example, the anticompetitive effects would in no way be diminished by the existence within each territory of competition among the products of different manufacturers.

As noted above, manufacturers normally do not have an incentive to use exclusive territorial arrangements when they are likely to permit distributors to restrict output and raise prices, but manufacturers will not always be adverse to exclusive territories established for reasons other than efficiency. The manufacturers themselves may wish to collude in order to restrict output and raise prices, and their collusion will not be fully effective unless they are able to prevent entry. The colluding manufacturers may therefore be willing to share their higher profits with the existing distributors to obtain their agreement that they will not distribute the products of any non-colluding manufacturers. In this situation, the exclusive territorial restrictions reinforce a clearly anticompetitive agreement.

The competitive conditions of many industries are such that it is relatively difficult for firms to use exclusive territorial arrangements in anticompetitive ways. When concentration levels and entry barriers are low, for example, collusion among competitors is difficult to enforce and is likely to generate new entry. On the other hand, high concentration and high entry barriers make it more likely that exclusive territorial arrangements will be used in an anticompetitive manner.

Before turning to a brief discussion of the malt beverage industry, we wish to emphasize that one cannot justify an antitrust exemption for a particular industry on the basis of evidence that competitive conditions in all or part of the industry make it relatively difficult for firms to use exclusive territorial arrangements in an anticompetitive manner. There are many industries in which such anticompetitive conduct may be difficult, and the antitrust laws serve a useful function in these industries by outlawing anticompetitive arrangements while permitting procompetitive arrangements.

Moreover, it appears that competitive conditions in the malt beverage industry are such that there are particular reasons for concern that exclusive territorial arrangements could be used in anticompetitive ways. The Commission's Bureau of Economics published a report on the brewing industry in 1978.7/ According to that report and more current publicly available information, the brewing industry is quite highly concentrated. Four firm concentration increased at the national level from 46 percent in 1970 to 63 percent in 1977, and we understand that it now exceeds 68 percent. Moreover, in most states, four firm concentration exceeds 80 percent. We also understand that wholesale concentration is high -- perhaps higher than brewer concentration

-- though we do not have reliable data on the structure of the malt beverage wholesale distribution sector. Finally, we understand that the laws of many states create entry barriers that restrict entry into the wholesale distribution of malt beverages. These facts do not indicate that there are necessarily any significant competitive problems in the malt beverage industry,8/ but the combination of high concentration and state-created entry barriers do make this an industry in which it is particularly important to safeguard against anticompetitive conduct such as collusion among brewers or wholesalers. In these circumstances, the proposed exemption seems particularly undesirable because it would increase the likelihood that exclusive territorial restrictions will be used to suppress rather than enhance interbrand competition.

Conclusion

The Commission is strongly opposed to the adoption of H.R. 3269. We are unaware of any evidence or principled argument that might justify the bill, and we believe that enactment of such unjustified special exemptions has the detrimental effect of undercutting the ability of antitrust enforcement to preserve this Nation's free market economy. Moreover, since the antitrust laws currently permit procompetitive exclusive territorial arrangements, the only exclusive territorial arrangements that could be legalized by a weakening of current antitrust standards are those arrangements whose overall effect is anticompetitive. Finally, our view of competitive conditions in the malt beverage industry serves to reinforce our opposition to H.R. 3269, for the industry appears to be one in which it is particularly important to safeguard against the anticompetitive use of exclusive territorial arrangements.

By direction of the Commission.

Signed and hand-delivered

James C. Miller, III
Chairman

END NOTES

1/ We have not analyzed market conditions to ascertain whether the assumption that there is a single malt beverage industry is in fact valid. For purposes of this letter, we assume that a single malt beverage industry exists.

2/ This and other statements herein referring to the position of supporters of H.R. 3269 are based upon the undated memorandum, entitled "The Proposed Malt Beverage Interbrand Competition Act," which you sent the Commission together with your request for comments on H.R. 3269.

3/ As noted below, it does appear that concentration at the brewer level of the industry is high, but concentration at the wholesale level may be even higher.

4/ For example, portions of the legislative history of the Soft Drink Interbrand Competition Act suggest that it did not create a legal standard different from the antitrust laws. See, e.g.,

H.R. Rep. No. 1118, 96th Cong., 2d Sess. 4-5, 16 (1980); 126 Cong. Rec. H5534 (daily ed. June 24, 1980). However, some legislative history supports a contrary result (see 126 Cong. Rec. at H5536-37), and one court has held that the act created a different standard of legality. Coca-Cola Co. v. FTC, 642 F.2d 1387 (D.C. Cir. 1981).

5/ Section 3 of the bill provides that it does not legalize "enforcement" of exclusive territorial restrictions by means of "price-fixing arrangements, horizontal restraints of trade, or group boycotts." Section 3 in no way lessens our opposition to H.R. 3269, because this provision in no way alters the fact that the only effect of weakening the current antitrust standard would be to legalize arrangements that are anticompetitive.

6/ The sole basis for the claim that there is a need for legislation to provide greater certainty in this area is the opinion in one California case, and that case is currently being reviewed by the United States Supreme Court. Norman Williams Co. v. Rice, 1980-2 Trade Cas. ¶63,484 (Cal. Ct. App.), cert. granted, 50 U.S.L.W. 3447 (U.S. Nov. 30, 1981) (No. 80-1012). We do not believe this case creates uncertainty about the proper antitrust analysis of exclusive territorial arrangements. We also note that we see no merit in the totally unsupported claim made by supporters of H.R. 3269 that the bill would provide beneficial confirmation of the regulatory authority of the states. So far as we are aware, there is no reason to question the states' full regulatory authority in this area. If any such question existed, H.R. 3269 would not remedy it since none of the bill's provisions deal in any way with state regulation of the malt beverage industry.

7/ FTC, The Brewing Industry: Staff Report of the Bureau of Economics (1978).

8/ Indeed, the Bureau of Economics' 1978 report concluded that the brewing industry was generally competitive.

The Commission is unable to compare the distribution of malt beverages to soft drink bottling in any ways that are useful to a consideration of the likely effects of H.R. 3269. Obviously, the costs incurred and risks faced in these industries differ substantially, and the activities typically undertaken by soft drink bottlers undoubtedly differ from those engaged in by malt beverage distributors. For example, soft drink bottlers participate in both the production and distribution of soft drinks, and they must bear the cost of transporting finished soft drinks over substantial differences. Malt beverage distributors, on the other hand, perform only a wholesaling function and apparently face lower costs than soft drink bottlers. These differences, however, are not particularly relevant in determining the likely effects of H.R. 3269.

Senator SIMPSON. The first panel is Ernest Gellhorn, dean, and Galen J. Roush, professor of law of Case Western Reserve University of Cleveland; Dr. Steve L. Barsby, Steve L. Barsby & Associations, Inc., of Falls Church, Va.; and Dr. W. John Jordan, associate professor of economics at Seton Hall University in South Orange, NJ.

I appreciate having your remarks. We will proceed with you, Mr. Gellhorn.

STATEMENTS OF ERNEST GELLHORN, A DEAN AND GALEN J. ROUSH PROFESSOR OF LAW, CASE WESTERN RESERVE UNIVERSITY, CLEVELAND, OHIO; DR. STEVE L. BARSBY, STEVE L. BARSBY & ASSOCIATES, INC., FALLS CHURCH, VA.; AND DR. W. JOHN JORDAN, ASSOCIATE PROFESSOR OF ECONOMICS, SETON HALL UNIVERSITY, SOUTH ORANGE, NJ

Mr. GELLHORN. Thank you very much, Mr. Chairman, for allowing me to participate in these proceedings. I have submitted a statement for the record and would like to reserve the opportunity to correct a couple of typographical errors on pages 4 and 5.

Senator SIMPSON. Indeed, without objection.

Mr. GELLHORN. I would like to respond specifically to the testimony we have heard from Assistant Attorney General Baxter of the Antitrust Division and Mr. Winslow of the FTC rather than concentrate on my prepared statement. I believe my statement is clear and does not require additional presentation.

There are four issues that have been presented this morning. One asks whether this industry is competitive. That is, is this the appropriate industry in which to adopt a somewhat different antitrust test?

The second considers the impact of S. 1680 on State law. A third question is why are the wholesalers and the manufacturers in this industry seeking this legislation. Finally there is the question of the meaning of substantial and effective competition, the legal test of S. 1680.

I would call your attention to the study done by the Federal Trade Commission in 1978, which itself concluded that despite the imbalance in market shares, other facts such as the change in market shares, the exit and entry into the industry, etc. make this industry a classic case of intense rivalry. If you look, for example, at pages 2 and 3 of that study by the Federal Trade Commission and its staff, it concluded that the dramatic changes in market shares in many States cast doubt on the assumption—and that is all that Mr. Baxter could offer us—that competition at the State or regional level is declining simply because four or eight firm concentration at the State or regional level is rising.

Indeed, that study points out, continuing again on page 3, that the real price of beer has been falling all the time. In other words, if there is an industry in which one might seek to adopt this kind of legislation, it is the brewing industry. And this is evidence that was in the record at prior hearings that I have testified before on the House side.

Contrary to what Mr. Baxter suggested—and I am hesitant to disagree with him because I admire his work so much and normally find myself in agreement with what he presents—the clear and

convincing evidence prepared by the Federal Trade Commission and submitted by its own staff in an unrefuted study is that this is an industry deserving of this kind of consideration.

The more disturbing question posed by Mr. Baxter is whether or not State limitations on entry and State controls on wholesalers would be a reason not to adopt this kind of legislation. Indeed, I would suggest that State limitations on entry by wholesalers are precisely why the beer industry is somewhat special and indeed justifies this kind of legislation.

Vertical territorial restraints, as Mr. Baxter himself has many times pointed out, are an alternative for producers to achieve the advantages of vertical integration without having to invest in the retail distribution as well as the production of a product or service. That opportunity is limited, indeed often prohibited, by State law. Vertical integration by contract—and exclusive territories are one illustration—is an alternative way to achieve these distributional gains. They can be used to overcome the free rider problems that Mr. Baxter so effectively pointed out.

What we have, in other words, in the beer industry is a series of State limitations on vertical integration by brewers. This legislation would allow the advantages of vertical integration consistent with State law and protect, frankly, the smaller brewer and the smaller entrant. At the same time it would assure the consumer the benefits of competition because we have an industry which the Federal Trade Commission's own study has demonstrated is one that is intensely competitive.

My final point is simply, does this legislation accomplish the task. I think the answer is clear. It adopts precisely the same language offered to the Senate and adopted by the Senate in the soft drink industry legislation in 1980. Its purpose is to clarify as well as codify the meaning of *Sylvania*; clarify it by focusing on competition among the brands, that is, competition between independent brewers. That competition is, as Justice Powell noted in the *Sylvania* case, "the primary function of the antitrust laws."

This legislation would eliminate the confusion of the cases. If I could just quote a sentence or two from a paper presented by Barry Brett on November 4, 1983, before the Ohio State Bar Association:

> Distribution and dealer termination cases are probably the single most active area of antitrust litigation today. Illustratively, in the last six months of 1982 there were 25 meaningful decisions purported in antitrust cases involving distribution restraints and 16 of them were at the Court of Appeals.

If ever there were an area for Congress to exercise its historic oversight function to clarify the law, dealer termination and vertical distribution cases are the ones in which they should do so.

One final note is that this bill would provide direction where others have confused it. One illustration is the FTC's decision in *Beltone*, a classic case of confusion.

Thank you very much.

[The prepared statement of Mr. Gellhorn follows:]

PREPARED STATEMENT OF ERNEST GELLHORN

My name is Ernest Gellhorn and I am Dean and Galen J. Roush Professor of Law at Case Western Reserve University, Cleveland, Ohio. My principal areas of practice, teaching and scholarly experience are in antitrust and administrative law.* Relevant to these hearings, I have written a text entitled "Antitrust Law and Economics", given speeches and published articles in antitrust, and previously testified before this Committee in support of the Soft Drink Interbrand Competition Act adopted by Congress in 1980.

Mr. Chairman, I appreciate the opportunity to appear before the Senate Committee on the Judiciary to testify regarding the Malt Beverage Interbrand Competition Act. (S. 1680). Having read the record of the hearings held a year ago before this Committee on a similar proposal, I wish to assure you and your colleagues that this bill fully serves the public interest. To be sure, it does not either freeze or radically alter the distribution of malt beverages, save or condemn small businesses, or otherwise greatly modify competitive conditions in the beer industry. However, it does present a significant opportunity for improving efficiency and freeing competitive forces in beer distribution. It will reduce uncertainty regarding applicable legal rules, properly protect distributor services against the inroads of free riders, and help assure that consumers receive the benefits of competition among brewers for their patronage. It is, in other

---

*The preparation of this testimony is being supported by the National Beer Wholesalers Association. My views, however, were developed independent of its support and reflect scholarly research and writing that preceded this relationship. Thus, I do not speak for the Beer Wholesalers.

28-889 O - 84 - 4

words, designed to make an important contribution to competition in the distribution and sale of beer and thus should gain widespread support once understood and reviewed dispassionately.

In light of the substantial testimony previously heard by the Congress on this bill, I have limited the scope and range of my testimony to three issues of apparent concern to the Committee. First, is this legislation necessary and in the public interest or, as some opponents have charged, only special interest legislation for the benefit of large brewers. Second, since beer sales are highly regulated at the state level, what reason is there for federal legislation. Why not leave it to the states to regulate if necessary. Third, does this Act create a new exception from the antitrust laws, and should the beer industry be given special status exempt from the requirements of competition.

There are additional significant issues related to these questions. One is the purpose and effect of this Act. Another is the effect of the Act on the antitrust laws and their application to the beer industry. An understanding of these critical and often complex legal issues further justifies approval of S. 1680. Thus, in considering the need for this legislation, I seek to analyze the terms of the Act and consider why it is appropriate for this industry.

1. Why the Malt Beverage Interbrand Competition Act (S. 1680) is Needed

In 1977 the Supreme Court reversed a ten-year old doctrine that had made it automatically illegal for manufacturers to restrict the territories in which their distributors or dealers sold their products. In doing so, the Court held in Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977) that nonprice vertical restrictions were to be evaluated under a rule of reason test. The Court recognized that several significant efficiencies could be achieved

by distribution restrictions. Among those cited by the Court were retailer and distributor investments, promotional activities, and quality controls.

However, the Court provided virtually no guidance to subsequent courts as to how the rule of reason was to be applied. It merely quoted at length from a famous but elliptical statement by Justice Brandeis (in the Chicago Board of Trade v. United States, 246 U.S. 231 (1918) identifying the elements of a rule of reason analysis. This has produced confusion and a flood of litigation. As numerous commentators have observed, the Supreme Court's mere identification of the elements of a rule of reason analysis -- the facts peculiar to the business, conditions before and after the restraint, the nature of the restraint and its purpose - does not provide useful instruction on how the test is to work in fact or even what it means.

Illustrative are the comments of two distinguished commentators:

> First, Professor (and now Dean) Robert Pitofsky: "The technique followed here of citing a paragraph of generally framed factors from a 1918 case, with no indication of how and why any particular factor is relevant or the priority and relative weight to be accorded to each, will surely breed further confusion and litigation in this area." The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions, 79 Columbia Law Review 1, 11 (1979) (emphasis added).
>
> Second, Professor (and now Judge) Richard Posner: "The common practice of including in jury instructions the passage .. from the Chicago Board of Trade opinion, often as the only guide to the concept of unreasonable restraint that is offered to the jury, imputes to jurors powers of comprehension that most of them lack." The Next Step in the

Antitrust Treatment of Restricted Distribution: Per Se Legality, 48 University of Chicago Law Review 6, 15 (1981).

Nor were lower courts or lawyers given guidance from other parts of the opinion in Sylvania. The Court had held that territorial restrictions should be considered sympathetically because: they could be used by entrants to penetrate new markets; they might be necessary to protect against "free riders" who otherwise would destroy incentives for dealer investment in promotion and service; and they could be important in manufacturer efforts to assure product quality and customer safety. Acknowledging that these restraints necessarily reduce or even eliminate competition among dealers of the same product (interbrand competition), the Court argued that "competition among the manufacturers of the same generic product (interbrand competition) --- is the primary concern of antitrust law." Nonetheless, the Court also stated, without elaboration, that some nonprice vertical restrictions could still be per se, illegal, and resale price agreements continued to be void.

Thus, the meaning of the rule of reason standard for nonprice vertical restrictions was left in a state of ambiguity. It was not clear, for example, whether the market power of the manufacturer was important. Nor did the Court indicate that interbrand costs were simply to be weighed against interbrand benefits -- and the restraint upheld unless the costs outweighed the benefits. Was it important that the likely adverse effects of any restriction were minimal or nonexistent even though interbrand competition was eliminated? Was a maufacturer to be punished with trebled damages and attorneys' fees if purported efficiencies were in fact not realized -- and the market had already exacted a toll for this mistake.

These and similar questions have provided lower courts with a steady diet of cases raising the question for lawyers: what is the standard of proof under the rule of reason in a territorial restraint situation? For one effort to provide guidance to lawyers and courts, I have attached as an appendix, the text of a speech I delivered to the 17th Annual Antitrust Institute of the Ohio State Bar Association in Columbus, Ohio on November 4, 1983.

For businesses, the question is somewhat different: What is the antitrust risk of agreeing to territorial restrictions in the distribution of one's product or services? As dozens of private antitrust lawsuits demonstrate, this risk seems increasingly substantial -- even though plaintiffs have prevailed only once on appeal. The threat of lawsuit by disgruntled retailers or terminated dealers and distributors now imposes a substantial cost on manufacturers as litigation charges escalate seemingly without limit or end. The greater loss, however, is that suffered by consumers and society. The result of this caselaw confusion is that the threat of litigation may dampen the vigor of competition in distribution as producers and distributors decline to adopt nonprice vertical arrangements that would intensify interbrand competition.

The Malt Beverage Interbrand Competition Act (S. 1680) seeks to clarify the application of antitrust law to territorial restrictions and codify the Supreme Court's intention in Sylvania by applying to the beer industry a standard first applied to the soft drink industry in 1980. The Act's primary substantive provision is Section 2's directive that territorial restrictions in distribution agreements for malt beverage products are not unlawful under the antitrust laws if "substantial and effective" interbrand competition exists. It would limit antitrust scrutiny of such contractual clauses to an initial determination of whether substantial

and effective competition exists with other malt beverage products in the geographic area defined by the territorial restriction. This result is consistent with the purpose of Sylvania.

A reading of S.1680 alongside the Supreme Court's opinion in Sylvania reflects their similar purposes. Each is based on an understanding that competition is enhanced through interfirm rivalry and that it is this area of antitrust law enforcement which should be the primary concern. That is, consumer welfare is generally improved through competitive efforts by independent firms seeking to increase their position in the market. This rivalry may involve lower prices, improved quality, better service, increased information through advertising, and so forth, all designed to attract consumer support.

In this connection, the competitive efforts of independent firms may be strengthened by lowering distribution costs, attracting effective distributors, retaining distributor loyalty and support, and focusing distributor efforts on increasing sales. These "efficiencies", the Supreme Court found in Sylvania, are likely to be aided by territorial limitations. By protecting distributors making such investments from free riders outside the assigned territory, increased distributor effort on behalf of the manufacturer is encouraged. The Supreme Court, therefore, concluded that nonprice vertical restraints such as territorial restrictions should be tested under a rule of reason analysis. Where interbrand competition exists - and thus is likely to be strengthened by geographic restraints - territorial restrictions are generally lawful under the antitrust laws.

What the Sylvania Court was saying, in other words, is that as long as a manufacturer faces competition in the sale of his product, the antitrust laws should be indifferent as to the restrictions he imposes on his distributors. At worst, he may discourage their performance, but the self-interest of the manufacturer and distributor will check any inefficient restrictions.

On the other hand, if these restrictions, in fact, enhance efficiency, they will improve the manufacturer's sales and reduce his costs - and thus strengthen his competitive position. The distributor will likewise benefit from increased sales (and profits) as will the consumer from lower relative prices. Society also benefits from increased productivity.

The simple dividing line for deciding whether the likely benefits of such vertical restrictions will clearly outweigh any costs is when the manufacturer's product faces competition. In that circumstance, the threat of a manufacturer or distributor cartel - policed by a territorial monopoly for each distributor - is nonexistent. Thus, when substantial and effective competition is present, there is no reason to challenge the restriction.

The effect of S.1680 is specific and clear. It would remove the uncertainty and confusion generated by lower court and agency decisions and assure the stability and continuity of the Supreme Court's ruling in Sylvania that nonprice vertical restraints are subject to a rule of reason analysis. Available evidence collected principally by the Federal Trade Commission and reported in its 1978 study, The Brewing Industry, establishes that substantial and effective competition exists in the brewing industry. S.1680 will thus shorten and simplify antitrust trials in most instances. Since territorial exclusivity is likely to improve distributional efficiency in this context, it should be encouraged.

II. Why State Regulation Is Not An Alternative

Since many states already have laws permitting territorial restrictions, the question can be asked whether state regulation of this issue is not a better solution. There are, I believe, several responses which demonstrate that state regulation is not a reasonable alternative.

The problem corrected by S.1680 has resulted from judicial interpretation of a federal law, the Sherman Antitrust Act. Except where state regulation ousts the federal law (because such regulation supplants the constraints of competition, see Parker v. Brown 317 U.S. 341 (1943), it is not within the authority of state law to decide the meaning of federal law. More importantly, the confusion here is one created by federal law and it is Congress' responsibility to clarify and correct that problem.

The basic policy of the antitrust laws in favor of competition should be fostered and encouraged, as S. 1680 seeks to do. The primary justification for encouraging differing state approaches is that the issue is local in nature or requires experimentation. Neither argument applies to territorial restrictions whose justifications are the same whether applied in Ohio, California or South Carolina. Beer is distributed nationally and distinctive state approaches will only increase distribution costs to the disadvantage of consumers.

III. Why The Malt Beverage Interbrand Competition Act (S. 1680) Is Not Special Interest Legislation

Despite uninformed claims to the contrary, S. 1680 creates neither an exception nor an exemption from the antitrust laws. Rather, it simply clarifies and codifies the legal test announced by the Supreme Court in Sylvania. That is, it would say that where substantial and effective competition exists among different brands of beer in a territory - and consumers are protected by this rivalry from any attempt to restrict output, raise price or reduce quality - it is permissible under the antitrust laws for producers to restrict the territories in which their distributors sell beer. On the other hand, where such competition is not present, t[illegible] al antitrust scrutiny applies to any vertical restraint.

Thus, adoption of S. 1680 would not eliminate antitrust review of nonprice vertical restrictions in the beer industry. It would merely assure that the correct test recognizing the benefits of nonprice vertical restrictions was applied to the beer industry. Nor is this a new or distinctive standard. It was previously approved by Congress when, in 1980, after lengthy hearings, it applied this measure to nonprice vertical restrictions in the soft drink industry.

If this Act is adopted, the beer industry will not gain an exemption from the antitrust laws. In point of fact, care was taken in drafting S. 1680 to prevent such an interpretation; Section 3 specifically provides that nothing in the Act shall be construed as legalizing price fixing, group boycotts, horizontal restraints of trade, etc. But where substantial and effective competition exists, and the consumers are receiving the benefits of competition, it serves no purpose to threaten firms operating in this market with antitrust liability and damage actions for territorial restrictions that can have no effect on interbrand rivalry. This legislation would, in essence, direct the courts and parties to prosecute more significant matters which have the potential of injuring consumers and the economy.

* * * * *

Approval of S. 1680 poses no threat to competition. Indeed, careful analysis shows that it is designed to preserve and foster that rivalry which is central to the policies of the antitrust laws. By enacting S. 1680, Congress would exercise its historic oversight function of assuring the proper interpretation of the law.

Senator SIMPSON. Dr. Barsby, please.

STATEMENT OF STEVE L. BARSBY

Dr. BARSBY. Mr. Chairman and members of the committee, my name is Steve L. Barsby. Thank you for giving me the opportunity to speak with you today regarding the economics of exclusive territories. I received my Ph.D. in economics at the University of Oregon in 1968, and during the past 16 years I have maintained full—or part-time faculty positions at the University of Arizona, City College of New York, and George Mason University. I have been an economist in the alcohol beverage industry for 11 years. My research in this industry has centered on the analysis of how different regulatory and taxing proposals will affect the structure and performance of the alcohol beverage industry. In this regard, I have published in both the academic and business community literature. My clients come from both the Government and private sector, including the U.S. Metric Board, the Advisory Council on Social Security, the National Association of Beverage Importers, the National Alcoholic Beverage Control Association—the association for control of State authorities—the U.S. Brewers Association, the Wine & Spirits Wholesalers of America, the Federation Internationale, the Illinois Package Store Association, advertising agencies, and individual companies in the beer, wine, and spirits industries. Within the past several weeks, the Treasury Department used retail price information developed by me in developing their estimates of the revenue gains from an incease in the Federal excise tax on alcohol beverages. I have prepared testimony for Federal court in Puerto Rico, State court in Arizona, and the Office of the Special Trade Representative, and testified at regulatory hearings in New Jersey and Arkansas. Alcohol beverage regulatory agencies in West Virginia, Oregon, Montana, Iowa, Maryland, and British Columbia have used my services. My separate studies of individual State markets include New York, Massachusetts, Vermont, Washington, D.C., Virginia, Colorado, and Washington State.

I would like to address three questions in my oral testimony today. First, how are wholesalers likely to behave in the absence of exclusive territories?

Second, why do manufacturers generally prefer to give wholesalers exclusive territories?

And, third, how does beer wholesaling currently measure up as a competitive industry?

First, in the absence of exclusive territories, wholesalers will concentrate on those customers which generate the largest profits. The typical wholesaler will actively pursue large buyers regardless of where those buyers might be located and ignore smaller buyers who might be located very close to them.

This is shown in my illustration contained in my written testimony.

Price competition for these large customers will be very aggressive. A number of wholesalers will fall by the wayside during this process. The wholesalers will be operating as order takers. They will tend to ignore secondary brands. They will not put major efforts behind promoting new brands or merchandising existing

brands. As a result, market information will be reduced and entry by new brands and suppliers will be more difficult. Finally, after competition has been eliminated, remaining wholesalers can raise prices.

Second, the view of most economists is that firms do what they think is good for them. If this view is correct, we must ask why most suppliers prefer to give their wholesalers exclusive territories.

If exclusive territories have the effect of raising prices without conferring additional benefits, consumers will buy less and suppliers will lose. Are suppliers going to be beneficent to wholesalers at their own expense? I do not think so. They must believe that exclusive territories are consistent with competition that acts to hold prices down and increase sales.

Third, the final question revolves around the performance of the beer wholesaling market. Beer wholesaling currently is conducted under conditions of exclusive territories in the majority of States. Such arrangements are mandated in 21 and permissible in each of the remaining States except 1. Every major beer producer obtains such distribution arrangements if possible.

Thus, the performance of beer wholesaling today reflects the effects of exclusive territories. Is this performance indicative of little or of substantial competition? Economists use a number of tests in measuring the extent of competition. Five of these are relative gross and net profit rates; rate of price increases; relative assets to sales ratio; the number of suppliers; and the amount of interbrand competition.

According to Dun & Bradstreet, beer wholesaling provides average or slightly below average profitability when compared to other wholesaling endeavors.

Retail price increases of beer have trailed the average of all consumer products as measured by the Consumer Price Index, rising only 58 percent as much as the overall CPI between 1967 and 1982.

Relative investment size is not a barrier to entry in wholesaling. The number of brewers has been falling, yet according to the BATF, there were 101 brewers in the United States in 1981. Additional competition for the domestic beer industry comes in the form of imports, and there are some 3,500 alcohol beverage importers, many of whom import beer. Thus, there is still a large number of beer suppliers in the United States and price competition among the brewers is intensive.

Finally, is there active interbrand competition? This competition can arise if consumers can select from a number of competing brands and if these brands are offered by different wholesalers. Hundreds of beer brands are available to consumers, many of them so similar that people cannot tell them apart in blindfolded tasting sessions.

Consumers freely substitute between beer, wine, and spirits on different consuming occasions, and surveys show increasingly that individual consumers are tied less and less to any given brand or beverage, especially those that are highly advertised.

According to the census of wholesale trade, in only 1 of the 21 largest SMSA's are there fewer than 10 wholesalers competing, and in these large markets the number of wholesalers competing is rising.

Thus, based on the measures of profit, price increases, required assets, number of suppliers, and interbrand competition, I conclude that beer wholesaling under a system dominated by exclusive territories measures up as a competitive industry.

Changes in this system which weaken competition are not in consumers' interests.

Thank you.

[The prepared statement of Mr. Barsby follows:]

Prepared Statement of Steve L. Barsby

Mr. Chairman and Members of the Committee:

My name is Steve L. Barsby. I am president of Steve L. Barsby & Associates, Inc., Falls Church, VA., an economic consulting firm specializing in the alcohol beverage industry.* I have been a professional economist in this industry since 1972, and my current clients include alcohol beverage regulatory agencies as well as industry members. Relevant to these hearings, I have prepared numerous studies regarding the impact of regulatory and taxing proposals on the performance and structure of the alcohol beverage industry, published articles in both the academic and business community literature, and prepared testimony for both federal and state courts on regulatory questions regarding the alcohol beverage industry.

Mr. Chairman, I appreciate the opportunity to appear before the Senate Committee on the Judiciary to testify regarding the economics of exclusive territories. In my testimony I first discuss the theoretical arguments regarding the conditions which must be satisfied for exclusive territories to raise prices to consumers and the likelihood of these conditions being satisfied in beer wholesaling; and how exclusive territories might influence non-price wholesaler behavior in those markets. I conclude that the conditions leading to higher consumer prices are not satisfied in beer wholesaling, and that exclusive territories tend to modify wholesaler behavior in a fashion beneficial to consumers as well as to suppliers. I then examine the extent to which beer wholesaling, under its current structure dominated by exclusive territories, performs by standard measures of "competitiveness". I conclude that by each of four common measures, beer wholesaling shows up as a competitive industry.

Origin of the "Three-Tier System

I believe that any analysis of the structure and performance of the alcohol beverage industry must begin with an understanding of the regulatory framework established immediately after the repeal of Prohibition by the 21st Amendment.

---

*The preparation of this testimony was supported by the National Beer Wholesalers Association of America, Inc. My views, however, were developed independent of its support and reflect research and writing that preceded this relationship. Substantial portions of this testimony were drawn from a study recently completed by me for the Wine & Spirits Wholesalers of America--The Economic Basis of Franchised Wholesaling in the Alcohol Beverage Industry, Washington, D.C., 1983.

Following Repeal, Congress passed the Federal Alcohol Administration (FAA) Act which defined many of the the basic structural characteristics of the alcohol beverage industry. In particular, it provided the basis for what has become known as the "3-tier system" by prohibiting suppliers from having interests in retail outlets, and by prohibiting many of the merchandising and promotion practices which were associated with the "tied house" before Prohibition.

The 3-tier system which resulted--suppliers, wholesalers, and retailers--was strengthened as all states passed legislation prohibiting either suppliers or wholesalers from participating in the ownership of retailers. States also enacted a variety of provisions covering such areas of commercial operation as credit, gifts, pricing, rebates, etc. In addition, many began regulating the channels of distribution for alcohol beverage products within their borders by requiring wholesalers to purchase from the original producer or importer ("primary source" laws), by requiring the goods to be delivered originally to authorized wholesalers (rather than drop-shipped directly to retailers), and by specifying whether wholesalers may be given exclusive distribution rights to a particular brand within a defined geographic territory. Twenty-one states now **require** that exclusive territories be given beer wholesalers.

In treating alcohol beverages as a "special case" in commercial regulation, the states were attempting to make enforcement of alcohol beverage laws easier, raise voluntary compliance to required commercial activities, and make payment of excise taxes more likely. State regulators wanted responsible, local firms to be the wholesalers, and they desired a clear audit trail for the movement of alcohol beverages from the supplier to the retailer.[1]

While federal and state regulators were most interested in enforcement, and in collection of revenues, they also established a framework in which the identity and functions of wholesalers were clear, and which lent itself to economic efficiency in product distribution.

The Wholesale Tier

Wholesaling in the U.S. is carried on by a number of different business forms, including "merchant wholesalers", brokers, manufacturers' offices, agents, etc. Merchant wholesalers--those which take actual ownership and possession of goods--are the dominant form of wholesaler organization in the U.S. According

to the latest Census data (1977), 95.6% of all beer wholesaling was conducted by merchant wholesalers.

Besides acting as a distribution conduit for goods, merchant wholesalers

--educate retailers about product characteristics,
--deliver, assemble and instruct on the use of point of sale materials;
--extend credit;
--provide local merchandising support;
--inform suppliers of local promotions which are likely to be successful; and
--pass sales and market data back to suppliers.[2]

Alcohol beverage wholesalers perform these functions where permitted by local law, and they also provide services such as stocking shelves and rotating retailers' inventories when needed (again, when permitted by law).

Besides performing a number of identifiable business functions, the mere existence of wholesalers increases distribution efficiency. They serve as an intermediate consolidation point between suppliers (each of which produces large volumes of a limited number of brands) and retailers (which individually sell small volumes of a high number of brands). As a result, the number of transactions and the associated costs needed to match all suppliers with all retailers is reduced.[3]

Exclusive Territories in Wholesaling

The granting of exclusive territories (either for wholesalers or retailers) falls into the category of "vertical restraints". Some students of business structure have treated exclusive territories as a factor which reduces competition, raises barriers to entry, and ultimately raises consumer prices. Courts and legislatures in different states increasingly are being asked to view the exclusive territory arrangement in alcohol beverage wholesaling as anti-competitive, and to prohibit such agreements between suppliers and wholesalers. At the same time, however, legislators continue to strengthen exclusive territory provisions.[4]

The view that exclusive territories are anti-competitive, and act to the detriment of consumers appears to be based on two assumptions:

1) that having exclusive rights to a territory for a specific brand gives wholesalers the ability to raise prices at will; and
2) that wholesalers' non-pricing behavior is not affected by the presence or absence of an exclusive-territory arrangement.

It is not clear that either assumption is correct.

1) Ability to Raise Prices

The ability to raise prices above "competitive levels" comes from supplying a product or service that no one else can sell (or is only sold by a few), **and that has no close substitutes.** Exclusive territories provide sole access to a market, but they do not insulate firms from competition of close substitutes. The closer these substitutes are, the lower the ability of firms is to raise prices.

Competition in a setting of exclusive territories comes from "inter-brand" competition (as opposed to "intra-brand" competition).[5] In inter-brand competition, firms compete by offering different brands which are close substitutes for each other. Prices are held down for any individual brand because consumers always have the alternative of purchasing numerous near-identical products from other sellers. The more alternatives consumers have, the stronger the competition among sellers.

In other words, the competition offered by wholesalers responsible for other brands erodes the monopoly power which might otherwise accompany exclusive rights to a given brand. As long as horizontal collusion does not occur, there is continual downward pressure on prices.[6] The alcohol beverage market is characterized by the existence of numerous brands which are virtually identical in character and price in every product category which can be identified. Furthermore, competition among the various alcohol beverages is strong. As a result, each brand faces competition from a number of directions, and the ability of any seller to raise prices is thus restricted. Markets characterized by exclusive territorial arrangements can be examined to see if industry structure is consistent with competitive activity, and broad measures of industry performance are available for measuring the intensity of competition.

2. Wholesaler Behavior

Locational theory can be used to examine the likely behavior of wholesalers competing under two alternative marketing

arrangements--one in which exclusive territories are granted; the other in which they are not. To do so for a highly-simplified example, assume that a wholesaler is located on the border of one state so its territory extends in one direction only.[7] Also assume that delivery costs are a simple function of distance, and that no other costs are incurred in servicing individual customers.

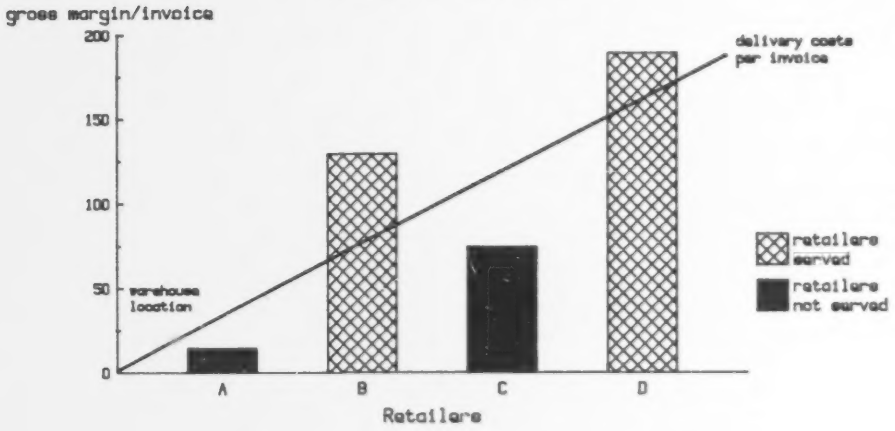
In the absence of territorial agreements, the wholesaler will be willing to sell to any retail customer whose orders yield more gross profits than the costs of delivery. Small retailers, even if located close to the wholesaler, may not receive service, while larger retailers will be served even if the delivery distance is very large.

These possibilities are illustrated in Figure 1 below. In this example, retailer A, even though closest to the wholesaler, will be ignored by the wholesaler because the gross margins offered by his orders do not make it worthwhile for the wholesaler to deliver. At the same time, the large orders of retailer D make it profitable for the wholesaler to deliver even though he is furthest away. The small retailer in the example may not be served even if numerous wholesalers operate in the market, because no wholesaler has incentives to serve him.

But this wholesaler must also compete with others using the same strategy. The wholesaler in Figure 1 may find that customer D prefers to buy from a second wholesaler located closer who can offer lower prices. As a result, customer D will be lost to our original wholesaler. To generate sufficient sales volumes for efficient operations, each wholesaler will attempt to extend his sales territory to include large customers wherever they may be located, and price competition from wholesalers located physically close to each other will eliminate all but the strongest. The long term results will be to diminish the number of competing wholesalers in any geographic area, weakening the price competition which originally led to the situation.

Intense price competition has other implications. The pressures on profit margins associated with such behavior will reduce wholesalers' merchandising efforts. Their function will gravi-

Figure 1
Servicing Profitability, Costs and Potential For Refusal to Deliver



tate towards that of an "order taker". They will tend to ignore secondary brands. Services to retailers will decline. They will not put major efforts into promoting new brands, and as a result, brand introduction will become more difficult. Not only might consumer choices be reduced over time, but new firms (both wholesalers and suppliers) will have more difficulty entering the market.[8]

The absence of exclusive territories thus leads to the following results:

1) exclusion of smaller retailers from handling brands available to larger retailers, thereby reducing consumer choice in markets served only by smaller retailers (more often central city areas). If these smaller retailers are served, it will be at substantially higher prices than made available to larger retailers;

2) price cutting will be temporary. The end result will be markets characterized by fewer, larger wholesalers than when the price competition began. These wholesalers will have substantial market power;

3) existing wholesalers will offer few services, either to retailers or suppliers. As a result, fewer brands will be available in any given marketing area, and barriers to entry for new suppliers will be higher.

Whether consumers' interests are being served in this type of market is doubtful. Those with access to the larger retailers may receive lower prices for a time, but eventually prices will tend to rise as competition among wholesalers falls. Those who cannot patronize the larger retailers will have their brand choices restricted, as many small retailers will be denied service by wholesalers. But even those buying from large retailers may find reduced choices as wholesalers and retailers concentrate on the most profitable brands and potential new suppliers cannot gain market entry.

Interests of Suppliers

The most reasonable assumption about business behavior is that each company attempts to serve its own interests. This is true for suppliers as well as wholesalers and retailers. Because the dominant preference of suppliers in the alcohol beverage industry is for exclusive distribution arrangements,[9] one must presume that suppliers believe they have something to gain from exclusive distribution arrangements.

Since suppliers do not benefit from higher margins at the wholesale and retail levels, their only gain can come from increased sales of their brands. Higher prices are more likely to reduce sales than to increase them. Why, then, would suppliers generally prefer exclusive territories if such arrangements raise margins--and thus profits--of wholesalers? The answer must be that suppliers do not believe higher prices are an automatic result of exclusive territories.[10]

At the same time, exclusive territories may not reduce prices. Suppliers prefer exclusive arrangements for four main reasons:[11]

1) desire for complete market coverage;
2) encouragement of higher wholesaler investment in market development;
3) encouragement of greater merchandising and marketing support from wholesalers; and
4) desire for efficiency gains in close business relation ships with wholesalers.

These are discussed in turn.

1. Market Coverage

As discussed earlier, if wholesalers are left to determine their own service areas, they will compete for the larger, more

profitable accounts (a practice termed "cherry picking"), leaving the smaller accounts for other firms to handle. Market penetration (distribution in a high percentage of potential retailer outlets) is important to alcohol beverage suppliers, because consumers of these products are not especially brand loyal. If their desired brand is not available in a particular outlet, they tend to buy what is available rather than to delay the purchase or to search among other retail outlets. This practice is expected on low-priced consumers items such as alcohol beverages as the costs of "search" rapidly exceed the expected benefits of that search.

In terms of Figure 1 presented earlier, a wholesaler with an exclusive territory agreement would be required to serve the small retail accounts "A" and "C" as well as the larger accounts. Some states have uniform wholesaler-to-retailer pricing laws which prevent wholesalers from charging the full cost of transactions to the small retailers. Only the service responsibilities created by exclusive territories provide the inducement for wholesalers to allow these outlets to be subsidized.

This outcome is inefficient from the standpoint of economic analysis. Yet, since the smaller outlets are going to be concentrated in outlying rural areas and in central cities--both areas with higher concentrations of lower income groups--it might be rational public policy to provide a regulatory framework in which consumer choice is widened in these areas.[12]

For alcohol beverages, especially beer, on-premise outlets are not especially large customers. They are among those outlets least likely to be served by a cost-cutting wholesaler. But a significant amount of consumer sampling takes place in these establishments, and suppliers denied distribution in them by such wholesalers have been closed off from an important avenue of exposure. Suppliers can get this exposure if they have exclusive distribution agreements. Without them, it is uncertain.

2. Wholesaler Investment in Market Development

Most new products do not create a level of immediate consumer demand sufficient to "pull" products through the distribution chain. Instead, most new products must be promoted to retailers as well as consumers so that they can receive favorable shelf placement and on-site "buy" recommendations. Much of this responsibility lies with the supplier. Wholesalers,

however, because of their sales force and local market contact, can make substantial contributions to this process.

Frequently, wholesalers are asked to "invest" in a new brand--supplying it at a loss during an introductory period in order to develop a profitable market later. For instance, the wholesaler's normal price could be $8.00 per case, but the introductory price to retailers is put at $6.50 per case. Extraordinary early marketing costs (such as point-of-sale displays, retailer window signs), however, may raise the wholesaler's costs to $8.50 per case. Short-term losses are thus $2.00 per case, with expected future profits of $1.00 per case.

The only condition under which a wholesaler will make this investment, however, is if he can be sure to capture the later gains of his early efforts. This can only be assured under an exclusive distribution arrangement. While established suppliers depend on local wholesaler investment, such dependence is even greater for new suppliers attempting to enter a market. New suppliers are less likely to have the capital available to provide sole support of early marketing efforts.[13] In this situation, exclusive territories act to reduce barriers to entry faced by new suppliers as well as by new brands.

3. Greater Merchandising and Marketing Support of Wholesalers

Wholesalers provide a large number of services in addition to physical distribution.[14] The more important of these include

1) maintaining adequate inventory so that ordering time of retailers and stock-outs can be minimized;
2) educating retailers about products--especially those newly-introduced to the marketplace;
3) introducing point-of-sale material to retailers and instructing them on its use;
4) extending credit;
5) helping suppliers devise promotional campaigns well suited to local market conditions; and
6) providing suppliers with information on local market trends, the developing needs of retailers, and on new laws and regulations.

Each of these activities imposes costs on cooperating wholesalers. If they are provided in a multiple-distributor framework

(absence of exclusive territories), other wholesalers who have not made these investments will "freeload" by selling at lower prices (not having made the investments, costs are lower). It is the assurance that they can capture the benefits of their investment (because of exclusive territories) that provides the inducements to the wholesalers to make that investment.

Without the protection offered by exclusive territories, wholesalers will not provide many of the services described above. Promotion efforts are reduced; retailers may not use the full range of sales materials available, or may use them inefficiently; suppliers lose substantial contact with local market conditions. Sales may fall as a result, and the merchandising efforts undertaken by suppliers may be ineffective and lagging behind local market conditions.

4. Close Relationship with Wholesalers

Suppliers benefit from strong wholesalers. Because of this, they

> ". . . may act as a general management consultant assisting distributors in marketing planning by studying marketing potential, forecasting, setting sales quotas, or planning inventories and promotional efforts. The supplier may also train sales personnel or managers of distributive firms, provide assistance in promotional efforts and sales incentives,. . . ."[15]

A supplier can engage in these activities if he knows that he will have a continuing business relationship with a distributor. Under conditions of multiple distribution, this certainty is absent, and the number of wholesalers with which the supplier must deal would be much larger.

Conclusions

The above discussions indicate that suppliers would support exclusive territories only if they result in increased sales. The arguments that such arrangements are associated with higher retail prices are not consistent with higher sales. Furthermore, substantial value accrues to suppliers who deal with wholesalers willing to invest in the introduction and continued merchandising of brands. Market penetration is improved, new products can be promoted better, and greater market intelligence flows back to suppliers when they deal with wholesalers having exclusive territories.

Alternate Distribution Frameworks

The wholesaling tier has been encroached upon by some suppliers trying to integrate forward, and by some retailers wanting to perform their own wholesaling function. The first has not proven successful in most industries where it has been tried, and the second may yield slim benefits for the consumer.

Why Don't Suppliers Integrate Forward?

Manufacturers in a number of industries have attempted to assume the wholesaling function, but such incursions into wholesaling usually have been abandoned. Fear of anti-trust prosecution is a deterrent, as is the generally lower return on equity earned by wholesalers than manufacturers. The massive capital requirements in building warehouses, acquiring and maintaining delivery vehicles, and in maintaining the product inventory itself add further disincentives. The entrepreneurial effort provided by owners is quite likely to be both cheaper and more effective than hired staffs. Finally, suppliers have found that duplicating wholesalers' facilities is one thing, but acquiring the knowledge of local markets is another.[16]

Direct Buying by Groceries and Chains

Some of the most vocal opponents of exclusive territories for alcohol beverages, including beer, have been grocery chains. They argue that their buying power, when combined with their local warehousing and distribution capabilities, will enable them to lower shelf prices to consumers.

At the same time, however, they use alcohol beverages (primarily beer and wine) as high-profit centers. In one sample of supermarkets covering 53 different product lines, gross margins on wine were 38.9%--3rd highest of the 53--and 25.5% on beer--20th out of the 53.[17] Since supermarkets are using these products as profit centers now, there is little expectation that they will pass savings on to consumers in the future.

Conditions in Beer Wholesaling

Little empirical work has been conducted regarding the economic performance of beer wholesaling either as a broad industry, or in the more narrow sense of how the market has performed under different regulatory schemes among the various states. Some measures of the competitive conditions in beer wholesaling, however, are available.

Exclusive Distributorships Dominate

Exclusive distribution arrangements dominate in beer wholesaling. They are required in 21 states, and are permitted in one form or another in 28 additional states (7 of which have no laws or regulations governing territories). In every state where permitted, the dominant practice is for them to be used. In some states, of course, transshipping and selling outside of established territories weakens the exclusive territory agreement. Only one state--Indiana--flatly prohibits exclusive territorial agreements. Thus, the industry-wide performance of beer wholesaling will primarily be a reflection of operations under exclusive distribution arrangements.

Economists traditionally use a range of measures to test the competitiveness of an industry. Among those commonly used are the following:

Relative gross and net profit rates. These measures are used because they give an indication of how much control individual firms have over their markups. The lower the gross and net profit rates, the less control firms have over their margins, and the more competitive the industry is likely to be.

Rate of price increase--in absolute terms, and compared to costs of inputs. More competitive industries are characterized by selling prices which rise slower than average, and by selling prices which move with price trends of their major inputs.

Relative assets/sales ratio. This provides a gross measure of the size of investment required to enter an industry. The lower the assets compared to sales, the easier entry is and the more competition there is likely to be.

Number of suppliers. The more suppliers there are, the more difficult it is for suppliers and wholesalers to collude on prices and other aspects of doing business. Consequently, a large number of suppliers is considered indicative of conditions conducive to competition.

Amount of inter-brand competition. Inter-brand competition refers to the marketing of different, rather than identical brands or products by various wholesalers. A high degree of inter-brand competition tends to hold

prices down and is a sign of competitive conditions in the market.[18]

How beer wholesaling meets these criteria is discussed below.

Profitability

Low profits may reflect inefficiency in operations, and can exist in markets characterized by monopoly as well as competition. Nevertheless, profitability is one of the key measures used by economists and the courts in determining the presence of competitive pressures.

Statistics for wholesaling profitability have been taken from Dun and Bradstreet in which wholesalers in 61 different product groups are included. Beer wholesalers rank 39th out of 61 when profits are measured as a percentage of net sales, and 27th out of 61 when measured by net profit compared to net worth.[19] By either measure, beer wholesaling provides average, or near-average profitability.

While no study exists comparing profitability of beer wholesaling in markets characterized by exclusive territories vs those not having such arrangements, a study of the distilled spirits industry performed this exercise. In that study, multiple regression analysis was used to measure the influence of exclusive territories on combined wholesale-retail markups. No statistically-significant association was found.[20] Thus, one cannot argue categorically that exclusive territories tend to raise prices.

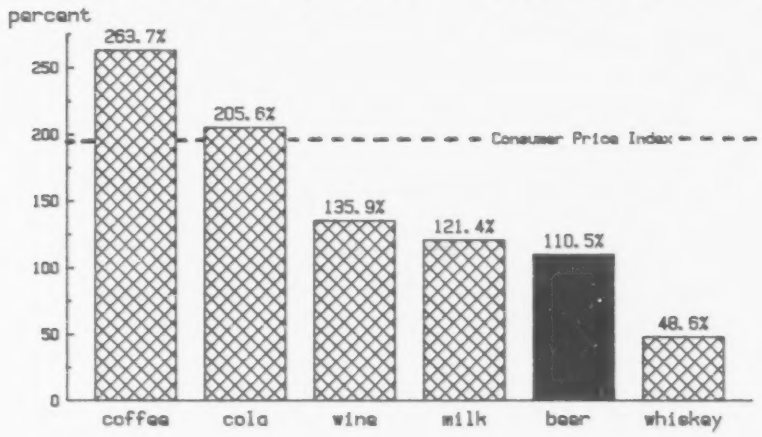
Price Trends

Retail beer prices have been rising slower than consumer prices for a number of years. According to the Consumer Price Index (CPI) retail beer prices increased by 110.5% between 1967 and 1982 while those of all consumer items rose by 189% (Figure 2).

Economists further argue that there is effective competition if the selling prices of firms maintain some regular relationship with the prices they pay for raw materials. Since beer from brewers is the prime component of beer wholesalers' operating costs, movements of beer prices at retail are compared to those from brewers. When retail prices are adjusted to take into account the rise in state excise taxes between 1967 and 1982 ($.22 per gallon to $.41 per gallon), retail prices moved upward at a near-identical rate to brewer prices.

Figure 2

Selected Beverage Price Increases, 1967 - 1982



Source: Bureau of Labor Statistics

One must conclude that beer wholesaling passes the "price movement" test of competitiveness.

Number of Suppliers

Markets in which there are numerous suppliers make it more difficult for collusion to occur, both among suppliers and between suppliers and wholesalers. The number of brewers has been falling in the U.S., and brewer concentration has increased. Yet in 1981, there were 101 domestic brewers, and 3,500 alcohol beverage importers--many of which import beer.[21]

Collusion is possible, but price competition among brewers generally is characterized as intense. Helleman Brewing (the 4th-largest brewer in the U.S.), for example, has been using pricing as a means of expanding its market share. While the imported market share of beer is still under 5%, it is growing rapidly, and the importers of these beers have almost all come from outside the domestic brewing community.

In summary, it appears as if the number of brewers is sufficient to make price collusion extremely unlikely.

Relative Sales/Assets Ratio

The ratio of assets to sales provides a gross test for the size of investment required to enter a market, with higher ratios being associated with greater barriers.

In merchant wholesaling, depreciable assets as a percentage of sales averaged 7.1% (based on the latest Census numbers) while that for alcohol beverage wholesaling (none was available for beer alone) was 6.2%. Thus, ignoring other factors affecting ability to enter, alcohol beverage wholesaling does not present an "investment barrier".

Interbrand Competition

Interbrand competition can be vigorous if variations in product characteristics are minor. In other words, consumers must perceive little actual difference between competing brands. When this is the case, consumers will readily change brands as price variations appear. The tendency for consumers to switch brands is especially high for alcohol beverages, and for those which are heavily advertised.[22] Furthermore, consumers increasingly are viewing the various alcohol beverages as substitutable products. While no study of price elasticity for individual beer brands is known to this researcher, one study of individual rum brands found that sales fell off twice as rapidly as the leading rum's price rose.[23] In a different study of the Scotch market, sales fell 1.5% for each 1% increase in price.[24] Other studies have found significant cross-elasticity of demand between beer and spirits.

A large number of beer brands are available to consumers in individual markets. In Western Massachusetts, for example, there were 86 different domestic brands offered in July 1983 along with 119 imported brands. While fewer than 86 domestic brewers supplied Massachusetts, there certainly is substantial room for consumer substitution among beer brands even ignoring competition from wine and spirits.

Interbrand competition also can occur if there is a meaningful number of wholesalers operating in a given market. Census data for 1977 show that there were over 10 beer wholesalers operating in 20 of the 21 largest SMSA's (see table above), and that the number of competing beer wholesalers in these regions has been growing over time.

Conclusions

When the exclusive territorial arrangement is examined in a context of intense inter-brand competition and valuable non-price competitive activities, it is seen to widen consumer choice and reduce barriers to entry. There is no evidence that it results in higher prices to consumers compared to the likely alter-

natives. The measures of industry competition discussed above, based on

--profit rates;
--rate of price increases;
--assets compared to sales;
--number of suppliers; and
--amount of inter-brand competition;

are consistent with beer wholesalers operating in a highly competitive environment even when the dominant marketing arrangement is for beer to be sold in exclusive territories. Profits are at or below average, prices increase slower than costs, the asset/sales ratio is low, the number of suppliers, while shrinking, is still large, and the opportunities for intense interbrand competition are present. One must conclude that exclusive territories have not resulted in a national pattern of low competition in beer wholesaling. On the contrary, the market is consistent with high competition.

Number of Beer Wholesalers Competing in the Largest SMSA Regions, 1967 - 1977

Metropolitan Area	Beer 1967	1972	1977
New York	134	98	129
Los Angeles	77	74	75
Chicago	111	102	94
San Francisco	47	46	40
Washington, D.C.	26	37	29
Dallas-Fort Worth	15	20	21
Houston	52	56	53
Boston	15	20	12
Nassau-Suffolk	n/a	30	31
St. Louis	34	38	41
Baltimore	23	22	25
Minneapolis-St. Paul	43	53	54
Atlanta	7	7	1
Newark	17	17	14
Anaheim	10	5	8
San Diego	18	15	13
Miami	12	15	16
Denver	11	18	19
Tampa	12	16	14
Phoenix	10	13	14
Cincinnati	n/a	n/a	23
Largest SMSAs	674	672	682

Note: Includes Specialty wholesalers with limited brand selection and sales volumes. SMSA totals for 1972 and 1977 exclude "n/a" SMSAs for earlier years.

Source: 1977 U.S. Census of Wholesale Trade.

Table 1

Exclusive Distribution Rules for Beer by State, 1983

State	Exclusives Required	Exclusives Permitted	Exclusives Prohibited
Arizona		X[a]	
Arkansas		X[a]	
California		X[a]	
Colorado		X[a]	
Connecticut		X[a]	
Delaware		X[a]	
Georgia	X		
Idaho		X[a]	
Illinois	X		
Indiana			X
Iowa		X[a]	
Kansas	X		
Kentucky	X		
Maine	X		
Maryland	X		
Massachusetts		X[a]	
Michigan	X		
Minnesota	X		
Mississippi		X	
Missouri	X		
Montana	X		
Nebraska	X		
Nevada		X	
New Hampshire	X		
New Mexico		X	
North Carolina	X		
North Dakota	X		
Ohio	X		
Oklahoma		X[a]	
Oregon	X		
Pennsylvania	X		
Rhode Island		X[b]	
South Carolina	X		
South Dakota		X[a]	
Tennessee	X		
Texas		X	
Utah		X	
Vermont	X		
Virignia		X[b]	
Washington		X	
West Virginia	X		
Wisconsin		X	
Wyoming		X	

[a]Wholesaler may not sell outside of a territory when one has been defined, although more than one wholesaler may carry a brand within a single territory.

[b]Brewers may not assign brands to more than one wholesaler within a territory, although wholesalers may sell outside their designated territory.

Source: United States Brewers Association, Special Information on Trade Practices,(Washington, D.C., 1983).

Note: Every attempt has been made to portray the general territorial provisions accurately. Readers are advised, however, not to rely on it as definitive.

FOOTNOTES

[1]For a more complete discussion of the origin of the three-tier system, see Fredrick M. Switzer, The Three-Tier System of Distribution in the Wine and Spirits Industry, 1975.

[2]See, for example, Richard S. Lopata, "Faster Pace in Wholesaling," Harvard Business Review, July/August 1969.

[3]Thomas G. Gies, Timothy J. Nantell, Raymond R. Reilly, Inflation in Wholesale Distribution. University of Michigan: Graduate School of Business Administration, 1980.

[4]So far during 1983, three states have either strengthened or enacted exclusive territory provisions of one nature or another in beer wholesaling. See Table 1 of this testimony.

[5]Lee E. Preston, "Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards," Law and Contemporary Problems, Vol. 30, 1965, p. 520.

[6]Charles Plott and Jonathon Uhl, "Competitive Equilibrium with Middlemen: An Empirical Study," Southern Economics Journal, Vol. 47, April 1981, pp. 1,063-1,071.

[7]The "standard general references for technical locational theory in economics include The Economics of Location, A. Losch (1954), Stability in Competition, Hotelling, and The Location of Economic Activity, E.M. Hoover, (1948). The following discussions are generally drawn from Lee E. Preston, "Restrictive Distribution Arrangements."

[8]Charles E. Stewart, "Exclusive Franchises & Territorial Confinement of Distributions," A.B.A. Section of Antitrust Law Proceedings, Vol. 22, April, 1963, pp. 33-47.

[9]Indeed, each of the major brewers negotiates exclusive territorial agreements in every market permitted by law.

[10]Richard Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," University of Chicago Law Review, Vol. 48, no. 1, winter, 1981, p. 23.

[11]See, for example, Lee E. Preston, "Restrictive Distribution Arrangements," p. 511.

[12]Preston, "Restrictive Distribution Arrangements," p. 522.

[13]Charles E. Stewart, "Exclusive Franchises & Territorial Confinement," pp. 37-38.

[14]Preston, "Restrictive Distribution Arrangements," p. 511.

[15]Donald Dixon, "The Impact of Recent Antitrust Decisions on Franchise Marketing," Marketing Channels, Morristown, New Jersey: General Learning Press, 1973, pp. 251-252.

[16]Lopata, "Faster Pace," pp. 132-133; Preston, "Restrictive Distribution Arrangements," p. 512; and Richard Caves and William Murphy, "Franchising: Firms, Markets and Intangible Assets," Southern Economic Journal, April 1976, p. 575.

[17]Chain Store Age/Supermarket, "1981 Supermarket Census," July 1981, pp. 38-304, July 1981.

[18]Preston, "Restrictive Distribution Arrangements," pp. 508-509.

[19]Dun & Bradstreet, Cost of Doing Business Ratios--Corporations.

[20]Steve L. Barsby, Affirmation and Retail Prices of Distilled Spirits: Implications for Beer, unpublished, 1981.

[21] Bureau of Alcohol, Tobacco & Firearms, Summary Statistics, Fiscal Year 1981.

[22]Richard A. Posner, "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," University of Chicago Law Review, Vol. 45, no. 1, fall, 1977, pp. 1-20.

[23]Steve L. Barsby, Testimony before the Environmental Protection Agency in the matter of National Pollutant Discharge Elimination System Permits, Docket no. II-WP-74-183.

[24]Steve L. Barsby, A Model for Forecasting Scotch Consumption, unpublished, 1981.

Senator SIMPSON. Thank you very much, Dr. Barsby. Dr. Jordan, please.

STATEMENT OF W. JOHN JORDAN

Dr. JORDAN. Thank you. Mr. Chairman, my name is W. John Jordan. I am an associate professor of economics at Seton Hall University in South Orange, NJ. I also have been studying the alcoholic beverage industry for several years, and in particular I have been examining the consequences of the network of exclusive distribution territories on beer prices.

In light of some of the findings that have been presented here and in some of your earlier hearings, I think that some of my results might be instructive. I believe that of particular interest to this committee and to the public as a whole is the question of what will happen to beer prices if this bill is enacted into law. And I believe that a picture of the likely consequences on beer prices of exclusive distribution territories is found by examining the experience of New Jersey in the last few years.

For many years New Jersey has had a system of de facto exclusive distribution territories. I should point out that by this I mean there are no State mandated exclusive distribution territories for beer wholesalers. Just as a matter of marketing practice, beer wholesalers have abided by this exclusive distribution system.

For example, each of the six Anheuser-Busch designated distributors and each of the nine Miller designated distributors has its own geographic territory in New Jersey in which it is the only seller of that product line. Until recently, State regulations have acted as a barrier to entry for independent businessmen who wanted to transship beer. Due to a series of court decisions, this situation has changed in the last couple of years, and a few transshippers are operating in the New Jersey market.

An indication of the savings to retailers available by buying from a transshipper can be found in a comparison of a recent set of prices offered by a transshipper to those set by all the Anheuser-Busch and Miller distributors in the State. It should be noted that the retailing of beer is very competitive in New Jersey, and that there is ample economic evidence to indicate that the retailer's savings will be passed on to the consumers in the form of lower prices. The existence and the magnitude of these savings is represented in table 1 of my written submission.

I will summarize those for you if you do not have them handy. Table 1-A indicates the savings by purchasing from a transshipper versus those from purchasing from the 9 designated distributors of Miller products for three quantity sizes, 100 cases, 300 cases, and 1,000 cases.

The savings to retailers by purchasing from the transshipper for 100 cases range from $34.94 to $136.11 depending on which of the 9 exclusive territories the retailer is located in. The savings in a 300 case purchase range from $44 to $408. And the savings on a 1,000-case purchase range from $40 to a staggering $1,350.55.

The corresponding percentage differences range anywhere from 1 percent to 17 percent. Let me emphasize that that is the savings to retailers associated by purchasing from a transshipper.

The large quantity discounts indicated there should not be viewed as benefiting only large retail stores, since in New Jersey retailers can form buying cooperatives, and they can act as one in their purchases and hence take advantage of large quantity discounts.

In addition to the striking amount of savings from transshipping indicated in these tables, is the sizable amount of savings available if a retailer could purchase from any designated wholesaler he chose. For example, even in the absence of transhippers, you will notice that there is a substantial difference in the price that the retailers have to pay, depending upon which area they are located in. For example, in area 6 for Miller beer, the retailer, if he wanted to purchase a 100-case size, would pay $8.95 a case. In area 7 he would pay only $8.01 for the exact same quantity, for the exact same quality of beer.

Just in conclusion, I should point out that transshipper A purchased his beer in New York, and the beer that he purchased was brewed in Newark, N.J. Now, what this means is that the beer was brewed in Newark, N.J., sent to a designated distributor in New York. The designated distributor in New York in turn sold it to a transshipper in New York at a profit. And the transshipper in turn sold it to a New Jersey transshipper who brought it back into New Jersey, sold it to retailers still at prices below what the brewery was selling in its neighborhood.

[The prepared statement of Mr. Jordan follows:]

Prepared Statement of W. John Jordan

Mr. Chairman and Members of the Committee: My name is W. John Jordan and I am an Associate Professor of Economics at Seton Hall University in South Orange, N.J. I have been studying for the last few years the alcoholic beverage industry in N. J. In particular, I have been examining the competitive consequences of the network of exclusive distribution territories set up by the beer industry. In light of some of my findings and how they contrast with some of the information that was communicated at the July 27, 1983 Hearings on S. 1680 the Malt Beverage Interbrand Competition Act, I felt my appearance here would be instructive.

The principal thrust of my statement concerns the impact of exclusive distribution territories on beer prices. Conflicting statements have been made by proponents and opponents of S. 1680, and the counterpart of this bill in the House, concerning this issue. The conclusions that should be accorded the most weight by this committee are those reached by an analysis rooted in realistic assumptions and sound methodology. It is for this reason that I will start with a brief comment on work previously presented before this committee regarding the impact of exclusive distribution territories on beer prices.

I was surprised at the suggestion by the proponents of this bill that the establishment of exclusive distribution territories will not lead to higher beer prices for retailers and consumers. This conclusion is contrary not only to the results of my research but also to what many economists would expect to find in an industry as concentrated as the beer industry. I thus read with interest the statement of Mr. Richard Willett in which this finding was contained. After reading this statement carefully, however, I feel that very few economists would agree with this conclusion or even the narrower finding that exclusive territories in Indiana did not result in higher beer prices.

The conclusion that there was "no noticeable change in the price of beer associated with the imposition of Rule 28 (in Indiana)" simply cannot be supported by the methodology employed. As indicated in his statement, effective transshipping in Indiana began in 1973/1974. Any noticeable reduction in the level of beer prices associated with this event (the issue at hand) therefore, could only be established by a comparison of beer price levels in the years 1973 and 1974.

28-889 O - 84 - 6

Examining, as he did beer price levels three years after the beginning of effective transshipping (his survey began in 1977), is far too late to test for the impact of an event that would make itself visible immediately.

It should be further pointed out that the remainder of his statement is predicated on the assumption that a state has exclusive distribution territories for beer only if it is mandated by state statute. Literally all of his conclusions are based on comparisons between states that have de jure exclusive territories and selected remaining states that are presumed not to have exclusive territories. In fact, however, the overwhelming majority of the states selected for this comparison had de facto exclusive distribution territories. This point was verified by directly contacting the controlling administrators or equivalent state officials in many of the selected states. Seven of the states that did not have de jure exclusive territories listed in his retail price comparison were randomly selected.[1] In each of these states, a state official confirmed that for years, a system of de facto exclusive distribution territories had been in existence for the distribution of the leading brands of beer. The likelihood that most of the states not contacted will have exclusive territories is thus also quite high. This fact renders meaningless all of the exibits and statistics presented by Mr. Willett that purportedly demonstrate the benign effects of exclusive territories.[2] Furthermore, it means that the claim that exclusive territories do not mean higher beer prices is completely unsubstantiated.

A picture of the likely consequences on beer prices of exclusive distribution territories is found by examining beer prices charged by a transshipper in N.J. relative to those set by designated distributors. For many years in N.J. the leading brands of beer have been wholesaled via de facto exclusive distribution territories. For example, each of the six Anheuser-Busch designated distributors and each of the nine Miller designated distributors has its own geographic territory in which it is the only seller of that product line. Until recently, state regulations have acted as a barrier to entry for independent businessmen who wanted to transship beer. Due to a series of court decisions this situation has changed in the

---

[1]Only New York was known a priori not to have exclusive territories. Seven out of the remaining 12 states were randomly selected and contacted.

[2]The one exception is Exhibit III which even he concludes shows the average price of beer in 8 Indiana cities to be lower than the average for two cities in Illinois and Kentucky (states with exclusive territories).

last couple of years, and a few transshippers are operating in the N.J. market. An indication of the savings to retailers available by buying from a transshipper can be found in a comparison of a recent set of prices offered by a transshipper with those set by all of the Anheuser-Busch and Miller distributors in the State. It should be noted that retailing of beer is very competitive in N.J. and there is ample economic evidence to indicate that for this reason retailer savings will be passed on to consumers in the form of lower prices. The existence and magnitude of these savings is presented in Tables IA and IB.

In Table IA the savings to retailers and ultimately consumers are shown for three different quantities of Miller High Life beer: 100 cases, 300 cases and 1000 cases. For a single drop delivery of 100 cases, savings by buying from transshipper A range from $34.94 to $136.11, depending on which of the nine exclusive territories the retailer is located in. Savings on a 300 case purchase range from $44.13 to $408.36, and those on a 1000 case purchase vary from $40.60 to a staggering $1350.55. The corresponding percentage differences in prices charged by designated distributors relative to transshipper A can also be calculated. Again, for Miller High Life beer a 100 case purchase ranges from 5% to 17%, for 300 cases from 4% to 17%, and for 1000 cases from 1% to 17%.

Table IB shows the same calculations when applied to the six Anheuser-Busch designated distributors in N. J. The savings again are significant even if somewhat smaller than those associated with Miller. The corresponding percentage differences in prices (AB distributor vs. Transshipper A) are for 100 cases 1% to 4%, for 300 cases 1% to 5%, and for 1000 cases from under 1% to 5%.

The larger quantity discounts (300 and 1000 cases) should not be viewed as benefitting only large retail outlets since small retailers may utilize the purchasing power of buying cooperatives. Retailers can group together and purchase beer as a single buyer in N.J. This enables all retailers to avail themselves of the potential savings associated with large quantity purchases.

In addition to the striking amount of savings from transshipping indicated in Tables IA and IB, are the sizeable amounts of savings available if a retailer could purchase from any designated wholesaler he chose. For example, retailers

located in the region serviced only by Miller distributor #6 pay 12% more than retailers located in the territory controlled by Miller distributor #7. This lack of intrabrand rivalry results in retailers and consumers in one region paying an unnecessarily high price for beer.

The anti-competitive consequences of exclusive distribution territories, especially in raising prices, calls into question any legislation that would promote them. This impact, combined with the invitation made to all other industries to secure similar exemption from the antitrust laws, puts S. 1680 at odds with consumer welfare.

TABLE 1A

RETAILER SAVINGS[1] BY BUYING FROM A TRANSSHIPPER VS. DESIGNATED DISTRIBUTORS HAVING EXCLUSIVE DISTRIBUTION TERRITORIES IN N.J.

Miller High Life (24-12 oz cans, 4/6)	The Miller Designated Distributors in N.J.									Transshippe
	1	2	3	4	5	6	7	8	9	A
100 Case Purchase Price/Case	8.86	8.96	8.77	8.14	8.31	8.95	8.01[m]	8.27	8.61	7.65
Savings by buying from Transshipper	125.46	136.11	115.88	48.78	66.89	135.05	34.94[m]	63.63	98.94	
300 Case Purchase Price/Case	8.86	8.96	8.77	7.94	8.31	8.95	7.76[m]	7.97	7.82	7.65
Savings by buying from Transshipper	376.41	408.36	347.66	82.47	200.69	405.17	24.96[m]	92.06	44.13	
1000 Case Purchase Price/Case	8.86	8.96	8.77	7.84[m]	8.31	8.95	7.76[m]	7.72	7.76[m]	7.65
Savings by buying from Transshipper	1254.70	1361.20	1158.85	168.40[m]	668.95	1350.55	83.20[m]	40.60	83.20[m]	

1 These savings are based on the price filings submitted to the N.J. Division of Alcoholic Beverage Control for the month of July, 1983 by International Beverage Distributors, a Transshipper, and all of the designated distributors for Miller High Life Beers. The savings indicated take account of differences in the 1-case list price, Monday discounts, C.O.D. discounts, quantity discounts and any savings on the N.J. Wholesale Sales Tax. They also take account of the 15 day credit differential between International Beverage's terms and the A-B distributors, and the 30 day credit differential of the Miller franchised distributors. It was assumed that those who purchase from the franchised distributors take the full 30 days to pay their bills and that the opportunity cost of the funds included was valued at 5%.

m - Monday only delivery for designated distributor. Orders must be received by 3:00 P.M. on preceding Friday.

TABLE 1B

RETAILER SAVINGS[1] BY BUYING FROM A TRANSSHIPPER VS. DESIGNATED DISTRIBUTORS HAVING EXCLUSIVE DISTRIBUTION TERRITORIES IN N.J.

Budweiser Beer (24-12 oz cans, 4/6)

	The Anheuser-Busch Designated Distributors						Transshipper
	1	2	3	4	5	6	A
100 Case Purchase Price/Case	8.65	8.95	8.90	8.75	8.91	8.94	8.58
Savings by buying from Transshipper	5.56	37.51	32.18	16.21	33.25	36.44	
300 Case Purchase Price/Case	8.60	8.95	8.90	8.60	8.91	8.94	8.53
Savings by buying from Transshipper	16.68	128.51	112.53	16.68	115.73	125.31	
1000 Case Purchase Price/Case	8.60	8.95	8.90	8.55	8.91	8.94	8.53
Savings by buying from Transshipper	56.29	429.04	375.79	3.04	386.44	418.39	

1 These savings are based on the price filings submitted to the N.J. Division of Alcoholic Beverage Control for the month of July, 1983 by International Beverage Distributors, a Transshipper, and all of the designated distributors for Anheuser-Busch Beers. The savings indicated take account of differences in the 1-case list price, Monday discounts, C.O.D. discounts, quantity discounts and any savings on the N.J. Wholesale Sales Tax. They also take account of the 15 day credit differential of the Miller franchised distributors. It was assumed that those who purchase from the franchised distributors take the full 30 days to pay their bills and that the opportunity cost of the funds included was valued at 5%.

m - Monday only delivery for designated distributor. Orders must be received by 3:00 P.M. on preceding Friday.

Senator SIMPSON. If anyone has any questions about that distribution system, send it in. [Laughter.]

Thank you. Now, just quick questions, please.

Dean Gellhorn, do you foresee any difficulties of proof, problems with delay, litigation problems, if there were to be this threshhold determination of substantial and effective interbrand competition as this bill requires?

Mr. GELLHORN. No; I think the experience in the soft drink industry would indicate that fewer lawsuits would be brought, and those that are brought focus on the single most important question: Is there competition in that market to protect the consumers?

Senator SIMPSON. OK. Now, Dr. Barsby, one of the requirements of this bill for special treatment under the antitrust laws for the industry is that there must be this substantial and effective interbrand competition. From your studies of the malt beverage industry, would you find any difficulty in determining that question, if the actual existence of such competition were being litigated?

Dr. BARSBY. I am sorry, I did not——

Senator SIMPSON. The actual existence of competition, if that was the issue being litigated, how do you fit the definition here?

Dr. BARSBY. The overall market is highly competitive, as measured by economists. Particular market conditions in individual States would be the question at issue there.

Senator SIMPSON. So, in your training and your background, you think that this is a sufficient definition to do the job? Substantial and effective interbrand competition.

Dr. BARSBY. Yes, I do.

Senator SIMPSON. You know, Dr. Jordan, you really set out the total complexity of this issue, and you know, we are laymen, and it often happens with the Judiciary Committee that competing groups in the country cannot resolve their differences and know them intimately and bring them to us while we are dealing with 1,000 others. It is a curious thing. It is very real. It is very vexatious to me. I am in my first term here.

But you have described beautifully the complexity and you described that with a great deal of background. That issue of price with regard to will the price—what will happen to prices if this bill is enacted, I do not know is the issue, because it is going to go back to the States for a determination and they will be free to require or prohibit exclusive territories under this.

So with the passage of this bill there might not—probably would not be any change in the status quo. That is possible. But you call into question some of Mr. Willett's methodology and conclusions. And I suppose that if we were to do a study and present it here that he would find some fault with some of those.

Is this a competition or a difference of opinion among economists, or are we, you know, just to stack opinion upon conclusion until we have become confounded? Is there any solid ground upon which we can really solve these questions?

Dr. JORDAN. An economist in deciding whether a market is viable takes into account structural measures and performance measures.

Now, the structural measures, unfortunately, are equivocal in that depending upon who the analyst is, they can interpret the re-

sults one way or another. I think the bottom line really is a combination of structural and performance measures. And a performance measure is going actually to a market and seeing what has happened in that market in the face of exclusive distribution territories. I think the New Jersey experience clearly does that, not only with regard to the impact on prices by allowing intrabrand competition, but also indicating that interbrand competition is not likely to be fostered in an area that is serviced only by exclusive territories.

Senator SIMPSON. I thank you all. That is helpful to the committee and I appreciate your presence.

The next panel, please, William Young, president of the General Wholesale Beer Co. of Atlanta; Richard M. Quinn, sales manager of the Beer Co. of Hartford City, Ind.; and Richard B. Willett, Alexander Grant & Co., Washington, D.C.

Please, if you would proceed in that order, I would appreciate it.

STATEMENTS OF WILLIAM YOUNG, PRESIDENT, GENERAL WHOLESALE BEER CO., ATLANTA, GA.; RICHARD M. QUINN, SALES MANAGER, THE BEER CO., HARTFORD CITY, IND.; AND RICHARD B. WILLETT, ALEXANDER GRANT & CO., WASHINGTON, D.C.

Mr. YOUNG. Mr. Chairman, my name is William Young. I am here today to speak in support of S. 1680. I have had an active involvement in the beer distribution business in Atlanta for 20 years. My family business has been there since 1946.

I am also here today speaking on behalf of the National Beer Wholesalers Association. There are more than 4,000 beer wholesalers in the United States who support this S. 1680. I would like to talk a little bit about our business, our customers, and the consumers we sell, so we can get to the basis of where we are to explain how it really works on a day-to-day basis and why the passage of 1680 is so important.

It would have a procompetitive effect on us, our customers and would also benefit the ultimate consumer. We beer distributors are by and large independently owned small businesses; 93 percent of us employ less than 50 people and make a profit before Federal and State income taxes of 4.6 percent on sales.

In total, we employ over 80,000 people and typically have $1 million invested in our warehouses, trucks, and equipment. From there similarity with other small businesses ends. The malt beverage business is vastly different than other American businesses in at least four ways.

First, and I think the most significant, the laws and regulations that surround our business make it clear that the products we sell are not to be marketed as other consumer products, such as corn flakes. There are restrictions on the marketing of our product that do not exist for other businesses. The repeal of Prohibition showed that the people desired to consume alcoholic beverages. Legislators at both the Federal and State level recognized, however, that it was and continues to be sound public policy to heavily regulate the manufacture, sale, and consumption of our product.

Unfortunately, we continue to read of the results of abuse at the consumer level and see major trends throughout the United States, I think.

Second, our business is different because—and I emphasize that historically beer in this country has been sold through a three tier system of marketing. Brewers sell to distributors; likewise, the distributors to the retailers, and retailers to the ultimate consumer. That system has stood the test of time, and is the overwhelming system that exists today. It is also the most efficient way to make all, retailers large and small, independently owned and chain stores, to see that they are given reliable service and the product is delivered to the ultimate consumer fresh.

My customers are retailers who are licensed by municipalities or counties or whatever governing authority is there. They are bars, restaurants, clubs, liquor stores, and independent grocery stores, and large chain stores. We call on all of our customers at least weekly and sometimes more often.

Third, we are different because the product we sell is a branded product with a limited shelf life. The consumer is accustomed to associating a certain taste with our brand. Therefore, we must protect it. It is a responsibility that we all share and assure ourselves that we have to deliver that product or otherwise we suffer the loss of it.

In my State of Georgia draft beer is about 12 percent of all the beer sold. It has a much shorter, naturally, shelf life because it is not pasteurized. We have to, therefore, make a substantial investment in large coolers and warehouses to keep a watchful eye on the cleanliness of everything that we do relative to draft beer.

Bottle and canned beer has a longer normal shelf life. The standard is set by the brewery. The standards vary by the breweries. If we do not maintain the quality of the product, we are subject to being terminated by our brewers. We are required by suppliers to watch the shelf life of this products in these warehouses and in the retail customers establishments.

We make sure that the product is rotated according to age at our warehouse and our trucks, on our trucks, and the retailers' coolers, floors, shelves, and storage rooms. When the normal shelf life date is exceeded, we pick up the beer from the retailer's place of business. We replace it with fresh beer and destroy the old beer at our cost.

If I was not the only Pabst distributor in the Atlanta market, the entire quality control program of the Pabst Brewing Co. would fall apart. I could not identify which Pabst I sold to the retailer and which Pabst some other distributor would have sold to the same retailer.

And I would certainly not spend money to control the quality of a product I did not sell. Yet, if my brand of beer goes off taste, even if I did not sell it, the brand suffers and so do I. That is because the consumer will switch, and he does, brand preference.

Fourth, we are different from other American businesses because of the unique relationship brewers have with the distributors. Indeed, we distributors become intimately identified with the brand we sell, such as our trucks are painted with the brand beer logo. We put up the suppliers point of purchase material. We spend

money on media advertising. We sponsor local community events. Our employees wear uniforms identified by the brewer and his product. Our buildings carry the logo.

In a word, my success and survival is tied to the success of the brand. It is precisely because my success and survival is tied to the brand of beer I sell that the malt beverage industry is so competitive at the distributor level.

At the distributor level, the drive for market share is relentless. Price competition between distributors is fierce.

Let me skip over and summarize.

Senator SIMPSON. If you could just summarize very quickly. I hate to do that, but I must leave.

Mr. YOUNG. All right. Thank you very much.

Has the system worked? Of course, it has. In the State of Georgia.

Senator SIMPSON. Can you do that in 30 seconds? I have a 12 o'clock appointment. I have stayed longer than I intended.

Mr. YOUNG. We have a very strict statute which mandates exclusive territories in Georgia, and it is under the supervision of the Georgia Department of Revenue, Alcohol, and Tobacco Tax. They follow it closely.

[The prepared statement of Mr. Young follows:]

Prepared Statement of William D. Young

Mr. Chairman and Members of the Committee:

My name is William D. Young. I am here today to speak in support of S. 1680.

I have had an active involvement in the beer distribution business for over twenty (20) years. Our family beer distribution business was founded in Atlanta, Georgia in 1946.

In addition to managing our family business, I have been active in political, religious, civic and charitable affairs of my community and state, not untypical of my fellow distributors. My involvement in the malt beverage industry outside of our own business has been with both the Georgia beer distributors association and the national association of independently owned beer distributors. I am on the board of the national association as an officer and am here today in that capacity to speak on behalf of the the more than 4,000 beer wholesalers in the United States who support S. 1680.

The National Beer Wholesalers' Association is an incorporated, non-profit national association of independently owned malt beverage distributors. Founded in 1938, its major purpose is to promote the general welfare of the independent distribution segment of the malt beverage industry through the preservation of the three-tier marketing system which has characterized this industry for almost fifty (50) years. We are also deeply concerned as citizens and attempt to make a meaningful contribution to solving some of society's problems. We have recently launched a nationwide Alcohol Abuse Education program, which will be paid for by the beer distributors. This is the first nonjudgmental, education program dealing with the

issue of alcohol abuse and is being made available at no cost to grade schools, junior and senior high schools across the nation. It was developed by FLI Learning Systems, a well known and highly qualified organization that develops school study programs.

I am here to talk about our business, our customers, and the consumers of the products we sell. I would like to explain how it really works on a day-to-day basis and why the passage of S. 1680 is so important.

Dean Gellhorn has already testified that S. 1680 would discourage frivolous antitrust lawsuits and shorten those involving nonpriced vertical restrictions because it would clairify the rule of reason test, by eliminating uncertainties now existant in lower court decision.

I only wish to add to this point that there have likewise been several State Attorneys General who have issued statements that the passage of exclusive territory statutes could violate the federal antitrust law even as described by the Sylvania opinion. The contention, therefore, of the Justice Department and the Federal Trade Commission that recent court decisions have clarified Sylvania and have provided an adequate test in the rule of reason, simply fly in the face of reality as it applies to the beer distributor's business. These decisions are leading to more confusion rather than less. As evidence of this, I need only cite the massive lawsuits in New Jersey where three (3) plaintiffs are suing every beer distributor in the state and every brewer and every malt beverage importer in America. The plaintiffs are essentially saying that exclusive territories or areas of primary interest as employed by brewers and distributors in New Jersey serve no lawful purposes and are per se violations of the anti-trust laws. As a result, they are anticompetitive and illegal under Sylvania, so they contend. Despite the massive confusion that has existed, most brewers are attempting to bring

some order to this chaos by once again redrafting distributor agreements to provide for exclusive territories. I believe that they should be commended for taking this step in view of the possible legal consequences they may suffer due to the confusion that exists in the so-called rule of reason of Sylvania.

S. 1680, if made into law, would remove the confusion of the rule of reason and replace it with a simple test. A test designed to protect the ultimate consumer. That test is the existence of significant interbrand competition in the market covered by the agreement.

Dean Gellhorn, in addition, provided the Committee with his expert testimony covering the relationship of S. 1680 and the general antitrust laws and the 21st Amendment, the underlying requirement in the bill is that there must be clear, substantial and effective interbrand competition before vertical territorial restraints could be put in place, and that S. 1680 is consistent with the role of Congress as exemplified by the passage of the Soft Drink Interbrand Competition Act. Those are reasons enough to warrant the passage of S. 1680.

However, I would like to discuss our business and explain why it is important that S. 1680 become law. It would have a pro-competitive effect on us, our customers, and would also benefit the ultimate consumer.

We beer distributors are, by and large, independently owned small businesses. 93% of us employ less that 50 people and make a profit before federal and state income taxes of 4.6% on sales. In total, we employ over 80,400 people, and typically have $1 million invested in warehouses, trucks, and other equipment.[1] From there, any similarity we have with small businesses ends. Not only are we vastly different than other small businesses from

[1] Source: U.S. Census Bureau and Beverage Marketing Corp. figures

a regulatory point of view, but we are a business where ferocious interbrand competition already exists as a daily way of life -- a business where, I believe, you will be convinced, exclusive territories are pro-competitive and anti-monopoly.

Malt Beverage Business Is Vastly Different Than Other American Businesses In At Least Four Important Ways.

First, our business was created by an Act of Congress. With the repeal of prohibition in 1933, Congress passed the Federal Alcohol Administration Act and created the Bureau of Alcohol, Tobacco and Firearms as the regulatory agency. Most significantly, these laws and regulations that surround them make it clear that the products we sell were not to be marketed as other consumer products, such as corn flakes, and they are not. There are restrictions on the dealings between distributors and retailers that do not exist for other businesses. The business person, for example, who sells Coca Cola syrup to a bar may own the dispensing equipment. A beer distributor who were to own the dispensing equipment which is used by a retailer to dispense keg beer, could lose his license or be heavily fined or both in most states. That is only one example of what has become known as "tied house laws" that exist at both the federal and state levels. Even credit terms between distributors and retailers and the packaging and labeling of the products are government controlled. Along side the federal laws and regulations exists a myriad of state laws, not all the same from state to state or between state and federal, because under the provisions of the 21st Amendment, the states may also regulate the importation and sales of alcohol beverages.

In some states, for example, distributors are required to collect and pay excise tax on beer to the state treasurer, thus acting as an arm of the government. In my state of Georgia I am

responsible in part for the collection of over $109 million in state and local taxes.

Distributors must also be familiar with the license laws and regulations that govern the retailer -- their customers -- including those laws and regulations that control opening and closing hours.

Secondly, our business is different because, and I emphasize, that historically, beer in this country has been sold through a three-tier system of marketing. Brewers sell to distributors, distributors sell to retailers, and retailers sell to the ultimate consumer. That system has stood the test of time and is the overwhelming system that exists today.

Brewers have concluded over the years that selling through independently owned distributors is the most effective and efficient way to compete in a highly competitive market. It is also the most efficient way to make sure all retailers, large and small, independently owned and megachains, are given reliable service, and that product freshness is maintained, all of which benefits the consumer.

The way the system works in practice is that distributors buy from brewers and typically pay the bill in ten (10) days. Distributors sell the beer to retailers either off of a route truck or by employing sales persons, take the order on one day and then have the beer delivered the next day or even the same day. My customers are retailers who have a license issued by the municipality. They are bars, restaurants, clubs, liquor stores, independent grocery stores, and large chain stores. We call on our customers at least once a week and we call on the larger users more than once a week.

Most of our customers are small independently owned businesses. This profile describes the typical beer distributor's business.

Thirdly, we are different from other American businesses, not only because the product we sell is an alcohol beverage that has to be marketed under a set of market guidelines provided by both the federal and the state governments, which are substantially different than those of other businesses, and not only because historically our products have been marketed through a three-tier system of marketing, but we are different because the product we sell is a branded product with a limited shelf life. By such terms as "shelf life", "freshness", "stale beer" and "dated beer" I and others in our industry mean that over a period of time, the taste of beer in the container, whether it be in kegs, bottles or cans, will change. There will come a point when the taste will change significantly from that of fresh beer. The consumer is accustomed to associating a certain taste with a specific brand. When that taste changes because of excessive aging, the consumer will switch to another brand. Exposure to high or freezing temperature can cause beer to go stale overnight. Sometimes the taste change is described as "off taste," sour, yeasty, green, metallic, -- the beer may become cloudy. In any event, no brand owner or his distributor want the customer to shift brand preference for that reason. Therefore, there has developed a very elaborate system to protect the taste -- fresh taste -- by avoiding excessive aging.

But it's not so simple. The shelf life of beer is not the same for all packages or even all brands.

In my state of Georgia, draught beer, that is keg beer, accounts for 12% of all beer sold. It is not pasteurized and must be refrigerated. It has a shelf life of 45 to 60 days from

the time it is produced even if it is kept refrigerated. If it is not, it will taste sharp and yeasty. In addition, the plastic line through which it is dispensed in the bar or restaurant must be cleaned every other week or the beer will take on a yeasty taste and become cloudy.

We, therefore, make a very substantial investment in large coolers in our warehouses, we keep a watchful eye on the cleanliness of the retailer's dispensing equipment, and take action where necessary in order to preserve the product's freshness, appearance and taste. We and our competitors have specially trained personel who are responsible for this important function.

Bottle and can beer has a longer normal shelf life. The standard is set by the brewery. It varies from 60 to 120 days if properly handled. It is not unlimited. Distributors are required by the brewery to protect the quality of the product. If they do not, the distributor's relationship with the brewery will be terminated by the brewery. Some breweries require distributors to store case beer in temperature controlled warehouses. Some require distributors to use refrigerated delivery trucks. These measures, which I have described above, are all taken to maintain the fresh taste and sparkle of the product and preserve the consumer's loyalty to the specific brand.

We are required by our supplier to watch the shelf life of their products in our warehouses and in our retail customer's establishments. We make sure that the product is rotated according to age at our warehouse, on our trucks, and in the retailer's place of business. As far as the retailer's place of business is concerned, we are concerned about rotation in his cooler, on his floor, on his shelves, and in his storage room.

28-889 O - 84 - 7

When the normal shelf life date is exceeded, we pick up the beer from the retailer's place of business, replace it with fresh beer, and destroy the old beer at our cost. The major chain stores do not rotate beer because they know it is the wholesalers problem so they leave it to us. Therefore, in terms of quality control, we are an extension of the brewery. We are held accountable by the brewery for the quality of the products in our market area. If I was not the only Pabst distributor in the Atlanta market, the entire quality control program at Pabst Brewing Company would fall apart. I could not identify which Pabst I sold to the retailer, and which Pabst some other distributor sold to the same retailer. And I would certainly not spend money to control the quality of a product I did not sell. Yet, if my brand of beer goes "off taste," even if I did not sell it, the brand suffers and so do I. That is because the consumer will switch brand preference.

Fourthly, we are different from other American businesses because of the unique relationship brewers have with distributors. This uniqueness surely comes from the three differences already stated. The contracts the brewers have with distributors usually require that the distributor be a member of the community in which the distributorship is located and be involved in the social, economic, and political life of that community. So, the relationship between the supplier and distributor does not end with quality control. Indeed, we distributors become intimately identified with the brand we sell. Our trucks are painted with the beer brand logo, we put up the supplier's point of purchase material, we spend money on media advertising in our local markets, we sponsor local community events in the name of the brand of beer we sell, our employees wear uniforms designated the brewer, our buildings carry the logo of the brand. In a word, my success and survival is tied to the success of the brand I sell.

The Malt Beverage Business Is Ferociously Competitive At Every Level

It is precisely because my success and survival is tied to the brand of beer I sell that the malt beverage industry is so competitive at the distributor level.

I have heard it said that passage of S. 1680 would be anti-competitive because interbrand competition is not enough. This observation can be made only by those who do not know our business or have a plan in mind to destroy the industry as we have known it for almost 50 years.

The competition at every level of our business is tremendous and always has been. The competition between manufacturers of beer, the brewers, is nothing short of awesome: Brewers promote their brands with tremendous advertising budgets, creative point of sale materials, incentive programs for distributors, tightly drafted agreements between them and the distributor covering quality controls, business methods, financial planning, plant and equipment, community involvement, image building, advertising, management and successor management.

In addition, frequent price discounts from brewers to distributor, passed on to the retailer and consumer are important elements to the competitive battle. The brewer will leave no stone unturned to sell his product at the expense of his competitors. That is called the battle for market share. The drive for increased market share by every brewer is relentless. This is even more so since industry sales have leveled off with no foreseeable change.

At the distributor level, the drive for market share continues. Price competition between distributors is fierce. In

Atlanta, we must be price competitive to sell Pabst Blue Ribbon Beer. I have a competitor who sells Miller, another who sells Budweiser, another who sells Schlitz, and Coors. We watch each other like hawks. We are all independent business people. If a retailer's price of a competitors brand is 5 cents lower than Pabst, for example, we are concerned as to how we may be affected. We have to be constantly aware of our competitors price at retail. The consumer may switch brand preference through price inducement. By the same token, there is a daily battle between us and our competing distributors for the retailer's floor space, shelf space and cooler space. And yet, we are the only Pabst distributor appointed by the brewery for the markets we cover. The same is true of the other brands we compete against. Why is this? Because it is only through this system that I am willing to invest my time, energy and money to engage in the daily competitive battle. My brewery requires that I call on every account, big or small, on a regular basis. I am held accountable for the freshness of its product. I am held accountable for the displays of his brand in the retailer's place of business. When I lose a keg account to a competitor, my brewer expresses its displeasure with my performance. I accept all of this because over the long run, I will through my efforts establish a business that has stability. Without exclusive territories, if a free rider comes along and picks off top accounts, he will destroy me. I will not be able to service the little accounts. No one will. And then the megachains will have completed their stranglehold on the distribution system. Anyone who suggests that there is not substantial, unrelenting, ferocious interbrand competition in our business is speaking utter nonsense. The passage of S. 1680 will not change that.

Has the system worked? Of course it has. Others have testified about the increase in the price of beer over the past decade relative to other products. It was much less. The

consumer has been given a wide choice of quality products at competitive prices, and all retailers, big and small, have received reliable service. In our business, only a system of exclusive territories will foster the substantial interbrand competition that will continue to reach down to the benefit of the consumer and prevent the monopoly that is being sought by those who oppose S. 1680. They hope to induce transshipping, a predatory combine of huge volume purchasing and a few free rider wholesalers that threaten to monopolize beer distribution sales.

Mr. Chairman, several witnesses before this Committee last year testifying in opposition to this bill cited a so-called "legislative study" in Indiana that proported to show a price drop of 20% upon passage of Rule 28. The thesis was then advanced that this bill will raise prices 20%. I have attached documentation of each of these instances to my testimony as Appendix A. We, after a very diligent search, can find no such study and you have heard evidence here today from Alexander Grant and Company "that there was no noticeable change in the price of beer." The passage of S. 1680 will not affect beer prices in any manner.

Conclusion

I have shown four ways in which our industry is vastly different from other American businesses:

1. We are creatures of the legislature, subject to federal and state laws and regulations that require a different system of marketing than other consumer products.

2. Historically, the three-tier system of marketing has benefited the consumer by providing a wide variety of products at bargain prices sold in a wide variety of retail outlets.

3. We sell a brand perishable product.

4. All of this has lead to a unique relationship between brewer, distributor, and retailer.

In addition, I have shown that our industry is ferociously competitive at every level and that the system of exclusive territories has enhanced the competitiveness and benefited the consumer.

These ideas have been widely accepted. Twenty-one states now require by statute beer distributors to have assigned exclusive territories by the brewery. Twenty-eight states permit such assignment. Only one state by regulation bars such assignment. The passage of S. 1680 will not change any state law now or in the future.

Dean Gellhorn has spoken of the need to clarify existing federal law. I ask for that clarification not just in the legal sense, but also in a practical business sense. The system of exclusive territories in Georgia works for the benefit of all our citizens. We need this legislation at the federal level to protect the law of my state and every other state including the state of Indiana.

Thank you for this opportunity to appear before you and I stand ready to answer any questions you may have.

APPENDIX A

STATEMENTS vs. FACTS

The following contain excerpts of written and oral testimony submitted to the Senate and House Judiciary Committees of the 97th Congress by Frederick Meijer and Michael DeFabis, Jr., respectively.[1]

1. Mr. Meijer -- "In Indiana, a state legislative study commission recently determined that the retail price of beer went down 20 percent when that state's law was changed to prohibit exclusive territories and to allow competition among beer distributors," pp. 139, (Senate Record - See footnote)

   Mr. DeFabis -- "In Indiana, a state legislative study commission on which I was privileged to serve recently indicated that the retail price of beer went down 20 percent when our State's law was changed to prohibit exclusive territories and to allow competition among beer distributors." (emphasis added) pp. 244, 247. (House Record - See footnote)

   FACT -- No legislative study was commissioned, performed, or released. Nor are there any documented facts to support such a conclusion.

2. Mr. Meijer -- "Exclusive territories in the beer business have been found to increase prices to consumers by as much as 20 percent." pp. 138, 144. (Senate Record - See footnote).

   FACT -- There is no documented evidence to support the statement. The argument is a corollary based on a false premise.

---

1 Full statements contained in Senate hearing records on S. 1215 (Serial No. J-97-123) and House hearing records on H.R. 3269 (Serial No. 82).

Senator SIMPSON. Thank you very much. I do not mean to be rude. I apologize. I hate to do this, and if I had known earlier, I would have better accommodated you all. I must leave, and I apologize to you. I wish I could stay through you, Mr. Quinn, and Mr. Willett. My apologies. Thank you, Mr. Young.

Steve Cannon of Senator Thurmond's staff and the subcommittee staff will hear the remaining testimony and inquire. And I will have some questions in writing. And thank you very much. I hate to do it this way.

Mr. YOUNG. Thank you.

Mr. CANNON. Mr. Quinn.

STATEMENT OF RICHARD M. QUINN

Mr. QUINN. Thank you. My name is Richard Quinn. My appearance today is on behalf of the Indiana Malt Beverage Association, of which I am vice president.

I am sales manager of the Beer Co., a beer distributorship in Indiana. We oppose S. 1680. Proponents of S. 1680 claim that wholesalers that engage in intrabrand competition are opportunists that skim the cream of the beer volume in the market and leave the small retailer to be serviced by the designated wholesaler.

An example of how we service small accounts is, for instance, the Schembre Beverage Co. of Kokomo, Ind. where in a recent 4-week period had 42 percent of its deliveries of fewer than 25 cases and only 4 percent of greater than 200 cases.

In our company in a recent period, 24 percent of our deliveries were cases of fewer than 25 and only 14 percent of deliveries of greater than 200 cases.

Proponents of this legislation claim that S. 1680 is needed because competitive wholesalers leave stale beer in the marketplace that another wholesaler must pick up. The fact is that we operate under the same brewery agreements as other Indiana wholesalers, and our contract requires us to perform the same quality control functions that they do.

Proponents claim that we are free riders and they have higher costs than we do. This is simply not true. We have advertising expenses. We operate again under the same brewery agreements which force us to incur the same costs. We have temperature controlled warehouses, trucks painted to brewery specifications, uniformed employees, who in our instance, for instance, are members of Teamster Local 135. We have call frequency standards, sales goals, a computerized ordering system, and I could go on.

Proponents of this legislation claim that those of us opposed to the beer bill cite some fictitious economic study in Indiana that supposedly shows that beer prices went down 20 percent when competitive selling began. Allow me to clarify that controversy. We opponents of this bill have merely pointed out that the Indiana Legislature created an Alcoholic Beverage Commission study committee in 1981. That committee held hearings and heard from expert witnesses and reported that the price of beer declined 20 percent as a result of competition.

That statement is reported in the record, the same kind of record that this committee establishes as a result of committee proceed-

ings. We have merely pointed to that statement in the record of the ABC study committee.

Further, there has been a contention that the price of beer in Indiana did not decrease when rule 28 was promulgated by the ABC in 1979. We agree. Rule 28 merely put an official sanction on competition in beer marketing in Indiana. This competition had been going on since 1974. So, certainly there was no price decrease coincidental with the promulgation of rule 28. The price decrease took effect in 1974 when competition began in the marketplace.

I was a beer distributor in Indiana at that time. Our average price per case to the retailer was approximately $6. When dock sales began, retailers in our market showed me price lists from dock sellers of beer that were $1.50 less than our price.

Our cost to deliver a case of beer at that time was 25 cents. That leaves a net difference of $1.25 or 20.8 percent less than our price. If that is not a price decrease, I do not know what is.

And this is based on my experience, and it was brought about through competition.

Therefore, it would appear that the ABC study commission's statement is not without merit. It is further confirmed by an Indianapolis Star price survey of Terre Haute, Ind., prices where there is little competition among wholesalers versus Indianapolis prices where there is considerable competition. That study, published in November 1982, showed that beer prices to consumers in Terre Haute averaged 19.8 percent higher than prices in Indianapolis.

Further, last Friday in testimony before the House Subcommittee on Monopolies and Commercial Law, New York Attorney General Robert Abrams stated that the price of Miller and Anheuser Busch products in New York City increased by 30 percent in the first 10 months after Anheuser Busch and Miller entered into exclusive territory agreements with their wholesalers.

During that same period and in that same environment, soft drink prices went up only 4 percent, according to the study cited by Attorney General Abrams.

As one who has spent 12 years as a beer wholesaler in Indiana, as a traditional protected wholesaler and more recently as an aggressive, competitive transshipper, I can state with complete confidence that in my experience, (a) it is a lot easier to operate in a protected market and (b) in order to survive in the free enterprise system, competition forces one to reduce prices, effect economies, increase volume, and whatever.

Six years ago we were small wholesalers. Had the giant established beer wholesalers reacted economically to our intrusion into their markets, they would have driven us out of their markets and out of business. But these noncompetitive wholesalers have gone and are still going to the Indiana General Assembly to ask it to solve their economic problems while we solve ours in the marketplace.

Thank you.

[The prepared statement of Mr. Quinn follows:]

PREPARED STATEMENT OF RICHARD M. QUINN

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

MY APPEARANCE TODAY IS ON BEHALF OF THE INDIANA MALT BEVERAGE ASSOCIATION OF WHICH I AM VICE PRESIDENT. THE INDIANA MALT BEVERAGE ASSOCIATION WAS FORMED SPECIFICALLY TO OPPOSE EXCLUSIVE TERRITORY LEGISLATION IN INDIANA. I AM SALES MANAGER OF THE BEER COMPANY, A BEER DISTRIBUTORSHIP IN INDIANA THAT HAS GROWN FROM A COMPANY SELLING 100,000 CASES OF BEER IN 1976, EMPLOYING 6 PEOPLE WITH 2 TRUCKS AND A 5,000 SQUARE FOOT WAREHOUSE, TO A COMPANY THAT SOLD 2,400,000 CASES OF BEER IN 1982, EMPLOYING 60 PEOPLE WITH A FLEET OF 23 TRUCKS AND TWO WAREHOUSES OF APPROXIMATELY 30,000 SQUARE FEET. WE OPPOSE S. 1680.

PROPONENTS OF S. 1680 CLAIM THAT WHOLESALERS THAT ENGAGE IN INTRABRAND COMPETITION ARE OPPORTUNISTS THAT "SKIM THE CREAM" OF THE BEER VOLUME IN A MARKET AND LEAVE THE SMALL RETAILER TO BE SERVICED BY THE DESIGNATED WHOLESALER. THE FACTS ARE THAT WE DERIVE 20% OF OUR BUSINESS FROM 80% OF OUR ACCOUNTS. THIS GREAT MAJORITY OF OUR ACCOUNTS IS MADE UP OF SMALL INDEPENDENT BUSINESSMEN WHO CHOOSE TO BUY FROM US BECAUSE WE HAVE A FAIR PRICE AND PROVIDE FULL SERVICE.

AS AN EXAMPLE OF HOW WE SERVICE SMALL ACCOUNTS, THE FOLLOWING IS A PROFILE OF THE DELIVERIES OF SCHEMBRE BEVERAGE COMPANY OF KOKOMO, INDIANA. FOR THE FOUR WEEK PERIOD ENDING FRIDAY, NOVEMBER 4, 1983:

Number of Cases Per Delivery	Percent of Total Deliveries
1-25	42%
26-75	36%
76-200	18%
200+	4%

FOR OUR COMPANY THE PROFILE FOR DELIVERIES FOR THE WEEK OF OCTOBER 24, 1983 IS:

Number of Cases Per Delivery	Percent of Total Deliveries
1-25	24%
26-75	32%
76-200	30%
200+	14%

ALSO, COMPETITIVE WHOLESALERS OFFER THEIR BEST VOLUME DISCOUNT PRICES TO BUYING COOPERATIVES. THAT IS, SMALL RETAILERS COMBINE THEIR ORDERS AND BUY AS A COOPERATIVE AND THUS RECEIVE THE SAME PRICE ADVANTAGE THAT OUR LARGEST VOLUME BUYERS ACHIEVE.

PROPONENTS CLAIM WE DO NOT CONTRIBUTE ANYTHING TO THE QUALITY OF LIFE IN THE COMMUNITY. WE CONTRIBUTE TO, ARE INVOLVED IN, AND HAVE A COMMITMENT TO VARIOUS CIVIC, CHARITABLE AND CULTURAL ORGANIZATIONS IN MANY OF OUR MARKETS. FOR EXAMPLE, I SERVE ON THE BOARD OF DIRECTORS OF THE INDIANA REPERTORY THEATER IN INDIANAPOLIS AND MY WIFE IS DIRECTOR OF THE INDIANA STATE SYMPHONY SOCIETY AND PRESIDENT OF ITS WOMEN'S COMMITTEE. I AM UNAWARE OF ANY DESIGNATED WHOLESALER IN INDIANAPOLIS INVOLVED IN ANY MAJOR CIVIC, CULTURAL, OR CHARITABLE ORGANIZATION IN THAT CITY. FURTHER, IN MUNCIE, INDIANA, ANOTHER MARKET IN WHICH WE COMPETE IN SELLING BEER, WE SPONSOR ANNUALLY THE MUNCIE BUDWEISER LIGHT ENDURATHON. WE SPEND THOUSANDS OF DOLLARS ON THIS EVENT AND TO THE BEST OF MY KNOWLEDGE WE ARE THE ONLY WHOLESALER THAT IS COMMITTED WITH PERSONNEL AS WELL AS CONTRIBUTIONS TO ANY CIVIC EVENT OF THIS NATURE IN MUNCIE.

PROPONENTS OF THIS LEGISLATION CLAIM THAT S. 1680 IS NEEDED BECAUSE COMPETITIVE WHOLESALERS LEAVE STALE BEER IN THE MARKETPLACE THAT ANOTHER WHOLESALER MUST PICK UP. THE FACT IS THAT WE OPERATE UNDER THE SAME BREWERY AGREEMENTS AS OTHER INDIANA WHOLESALERS AND OUR CONTRACT REQUIRES US TO PERFORM THE SAME QUALITY CONTROL FUNCTIONS AS THEY DO. WE BACK UP EVERY CASE WE SELL WITH A FULL SALES FORCE OF 10 PROFESSIONALS, SUPPLEMENTED BY QUALITY CONTROL TEAMS THAT MONITOR THE AGE OF BEER AND ROTATION OF PRODUCT IN ACCOUNTS WE SELL. IF BEER DOES BECOME OVER-AGE ON A RETAILER'S SHELF, WE REPLACE THAT BEER AND DESTROY IT AT OUR EXPENSE.

I HAVE DESCRIBED TO YOU WHAT KIND OF BUSINESSMEN WE ARE. WE ARE WHAT IS REFERRED TO AS TRANSSHIPPERS. PROPONENTS OF THIS LEGISLATION WOULD HAVE YOU BELIEVE THAT TRANSSHIPPERS ARE FLY-BY-NIGHT OPPORTUNISTS. IN MY OPINION A TRANSSHIPPER IS JUST A NEGATIVE WAY OF SAYING COMPETITOR. IF YOU STILL HAVE ANY QUESTIONS CONCERNING THE LEGITIMACY OF TRANSSHIPPERS, I WILL BE GLAD TO RESPOND BECAUSE PROPONENTS OF THIS LEGISLATION HAVE PAINTED AN INACCURATE AND MISLEADING PICTURE OF WHOLESALERS WHO WANT TO COMPETE.

PROPONENTS OF THIS LEGISLATION CLAIM THAT ITS ENACTMENT WOULD PROTECT THE SMALL WHOLESALER FROM LARGE COMPANIES SUCH AS OURS. IF EXCLUSIVE TERRITORIES HAD BEEN IN EFFECT IN INDIANA IN 1976, WE WOULD NOT HAVE HAD THE OPPORTUNITY TO GROW IN A PERIOD OF SIX YEARS FROM ONE OF THE SMALLEST DISTRIBUTORS IN THE STATE TO INDIANA'S LARGEST. WE WOULD HAVE BEEN LOCKED INTO A SMALL UNECONOMICAL TERRITORY AND OUR ONLY SOLUTION WOULD HAVE BEEN TO

RAISE THE PRICE OF BEER TO THE RETAILERS IN OUR ASSIGNED AREA WHO WOULD HAVE HAD TO BUY FROM US REGARDLESS OF OUR PRICE OR SERVICE BECAUSE THEY WOULD HAVE HAD NO ALTERNATIVE SOURCE OF SUPPLY.

PROPONENTS OF S. 1680 CLAIM THAT THE BEER INDUSTRY IN INDIANA IS IN A STATE OF CHAOS AND SHAMBLES AND THAT EXCLUSIVE TERRITORIES ARE NEEDED TO RESTORE AN "ORDERLY MARKET". IN DISCUSSING OUR BUSINESS AND NEW INNCVATIVE TECHNIQUES WHICH WE HAVE PUT INTO PLACE RESULTING IN EFFICIENCIES OF OPERATION, LOWER PRICES TO THE RETAILER AND ECONOMIES OF SCALE FOR US, I LEARN THAT THESE ARE PROCEDURES THAT OTHER BUSINESSES HAVE BEEN USING FOR YEARS. YES, IF YOU HAVE THE MINDSET OF AN INHABITANT OF AN INSULATED LITTLE WORLD APART FROM THE REALITIES OF THE FREE ENTERPRISE SYSTEM, YOU WOULD SEE INDIANA'S WHOLESALE BEER MARKET AS CHAOTIC. BUT, IT IS, IN EFFECT, THE REAL WORLD OF COMPETITION. IT IS HEALTHY FOR BUSINESS AND GOOD FOR THE CONSUMER.

PROPONENTS CLAIM THAT WE ARE FREE RIDERS AND THEY HAVE HIGHER COSTS THAN WE DO. THIS IS SIMPLY NOT TRUE. WE HAVE ADVERTISING EXPENSES. WE OPERATE UNDER THE SAME BREWERY AGREEMENTS WHICH INCUR THE SAME COSTS. WE HAVE A TEMPERATURE-CONTROLLED WAREHOUSE, TRUCKS PAINTED TO BREWERY SPECIFICATIONS, UNIFORMED EMPLOYEES WHO ARE MEMBERS OF TEAMSTER LOCAL 135, CALL-FREQUENCY STANDARDS, SALES GOALS AND A COMPUTERIZED ORDERING SYSTEM.

PROPONENTS OF THIS LEGISLATION CLAIM THAT THOSE OF US OPPOSED TO THE BEER BILL CITE A FICTITIOUS ECONOMIC STUDY IN INDIANA THAT SUPPOSEDLY SHOWS BEER PRICES WENT DOWN 20% WHEN COMPETITIVE SELLING BEGAN. ALLOW ME TO CLARIFY THAT CONTROVERSY. WE OPPONENTS OF THIS BILL HAVE MERELY POINTED OUT THAT THE INDIANA LEGISLATURE CREATED AN ALCOHOLIC BEVERAGE COMMISSION STUDY COMMITTEE IN 1981, HELD HEARINGS AND HEARD FROM EXPERT WITNESSES, AND REPORTED THAT THE PRICE OF BEER DECLINED 20% AS A RESULT OF COMPETITION. THAT STATEMENT IS REPORTED IN THE RECORD -- THE SAME KIND OF RECORD THAT YOUR COMMITTEE ESTABLISHES, MR. CHAIRMAN, AS A RESULT OF COMMITTEE PROCEEDINGS. WE HAVE MERELY POINTED TO THAT STATEMENT IN THE RECORD OF THE ABC STUDY COMMITTEE.

HOWEVER, IT WOULD APPEAR THAT STATEMENT IS NOT WITHOUT MERIT AS POINTED OUT IN AN INDIANAPOLIS STAR PRICE SURVEY OF TERRE HAUTE, INDIANA PRICES WHERE THERE IS LITTLE COMPETITION AMONG WHOLESALERS, VERSUS INDIANAPOLIS PRICES WHERE THERE IS CONSIDERABLE COMPETITION. THAT STUDY PUBLISHED IN NOVEMBER

1982 SHOWED THAT BEER PRICES TO CONSUMERS IN TERRE HAUTE AVERAGED 19.8% HIGHER THAN THE PRICES IN INDIANAPOLIS. FURTHER, LAST FRIDAY, IN TESTIMONY BEFORE THE HOUSE SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW, NEW YORK ATTORNEY GENERAL ROBERT ABRAMS STATED THAT THE PRICE OF MILLER AND ANHEUSER BUSCH PRODUCTS IN NEW YORK CITY INCREASED BY 30% IN THE FIRST TEN MONTHS AFTER ANHEUSER BUSCH AND MILLER ENTERED INTO EXCLUSIVE TERRITORY AGREEMENTS WITH THEIR NEW YORK WHOLESALERS. DURING THAT SAME PERIOD AND IN THAT SAME ENVIRONMENT, SOFT DRINK PRICES WENT UP ONLY 4% ACCORDING TO THE STUDY CITED BY ATTORNEY GENERAL ABRAMS.

AS ONE WHO HAS SPENT TWELVE YEARS AS A BEER WHOLESALER IN INDIANA, BOTH AS A TRADITIONAL PROTECTED WHOLESALER AND MORE RECENTLY AS AN AGGRESSIVE, COMPETITIVE TRANSSHIPPER, I CAN STATE WITH COMPLETE CONFIDENCE THAT IN MY EXPERIENCE A) IT IS A LOT EASIER TO OPERATE IN A PROTECTED MARKET, AND B) IN ORDER TO SURVIVE IN THE FREE ENTERPRISE SYSTEM, COMPETITION FORCES ONE TO REDUCE PRICES, EFFECT ECONOMIES IN YOUR OPERATION, INCREASE VOLUME, AND TARGET SPECIFIC GEOGRAPHICAL MARKETS AS WELL AS RETAIL ACCOUNT PROFILES.

INDIANA CURRENTLY HAS 138 BEER WHOLESALERS SERVING THE NEEDS OF THE RETAIL COMMUNITY IN OUR STATE. THIS IS A GREAT NUMBER OF WHOLESALERS TO SELL 40 MILLION CASES OF BEER. MILLER BREWING COMPANY HAS TESTIFIED IN THE INDIANA LEGISLATURE THAT IT HAS MORE DISTRIBUTORS IN INDIANA PER CASE SOLD THAN IN ANY OTHER STATE. CONTRAST OUR 138 WHOLESALERS WITH ONLY 15 LIQUOR WHOLESALERS IN THE STATE OR FEWER THAN 20 WHOLESALE GROCERS. SMALL RETAILERS IN INDIANA FIND NO SCARCITY OF SUPPLIERS OF LIQUOR OR GROCERIES WHO WANT THEIR BUSINESS.

SIX YEARS AGO WE WERE SMALL WHOLESALERS. HAD THE GIANT ESTABLISHED BEER WHOLESALERS REACTED ECONOMICALLY TO OUR INTRUSION INTO THEIR MARKETS, THEY WOULD HAVE DRIVEN US OUT OF THEIR MARKETS AND OUT OF BUSINESS. BUT THESE NON-COMPETITIVE WHOLESALERS HAVE GONE AND ARE STILL GOING TO THE INDIANA GENERAL ASSEMBLY TO ASK IT TO SOLVE THEIR ECONOMIC PROBLEMS WHILE WE SOLVE OURS IN THE MARKETPLACE.

general agreement that rule 28 did not bring about a decrease of beer prices in Indiana. We think what is important now is to look at Indiana prices versus the rest of the country.

As I have pointed out, we compared retail beer prices in Indiana with those in other States, using price data collected by a national market research organization in 1981. This is the most recent information available that happens to include Indianapolis. That is why we have used 1981 data. Prices in the survey contained both State and local taxes. We have factored out State taxes, including excise taxes, which do vary, as you know, substantially from State to State; local taxes are included.

The table clearly shows that the retail price of beer in Indianapolis is not lower than in all other areas, which would appear to be the contention of the opposition. The prices are higher in 13 other States, but they are lower in 9 others. The existence of exclusive territories, as is also shown on the chart, does not mean that the retail price of beer will be high.

We summarize the data on these two charts and some other information that I have in the testimony: Far from leading to a 20 percent decrease in Indiana retail beer prices, rule 28 had no effect whatsoever.

But I think more importantly, insofar as the retail price in major metropolitan areas of the United States is concerned and as far as it is a true measure of State retail prices, no pattern of higher pricing appears associated with territorial restrictions. This can be seen by the chart. To the extent that Indianapolis mirrors Indiana and Indianapolis is the center of transshipping in the State, it stands only slightly below the middle in price. In 1981 a six pack was about $2.50 in Indiana and the price range was from slightly above $2 to a little bit over $3 around the country. As we pointed out, 13 cities in this survey had higher prices while 9 have lower.

We also looked at wholesale concentration in the beer business. We analyzed available data in the beer wholesale industry that can be used as indicators of concentration at the State level.

We combined this data with data regarding those States which operate with exclusive territories and with available pricing data in order to identify any patterns. In order to completely assess the impact of exclusive territories on wholesale concentration, it would be necessary to examine data for individual markets. Such local market data is not readily available, particularly at the brewer/brand level. In the absence of information on local markets, data on wholesaler concentration at the State level was developed from the beverage data bank maintained by the Beverage Marketing Corp.

Based on this data, States with fewer than 10 wholesalers controlling 30 percent or more of the market were identified. We have a couple of exhibits in the testimony that I think show exclusive territories do not increase concentration in any markets in the country. Those exhibits are not available today, but they are in the testimony.

As shown by the tables in the testimony, exclusive territories do not lead necessarily to market concentration. About a third of the States with a fairly high market concentration have exclusive territories and two-thirds do not.

Based on our findings, we draw two conclusions regarding concentration in wholesale beer sales. No. 1, there is no evidence that exclusive territory restrictions will result in higher wholesaler concentration. As shown on our charts in the testimony, the written testimony, 14 of the 21 States and the District of Columbia with high wholesale concentration did not have exclusive territories.

In the 29 States which are not included in the high concentration category, 11 operate with exclusive statutes and 18 operate without them. The retail price of beer is not higher in those States with a higher degree of concentration and exclusive territories.

Thank you very much.

[The prepared statement of Mr. Willett follows:]

PREPARED STATEMENT OF RICHARD B. WILLETT

Good morning, Mr. Chairman and members of the Committee. I am Richard B. Willett, a partner of Alexander Grant & Company, an international accounting firm. We have 60 U.S. offices and about 2,700 employees, most of whom are engaged in auditing and financial analysis. I am a Certified Public Accountant (CPA), Certified Management Accountant (CMA), and Certified Management Consultant (CMC).

My principal areas of practice are financial and economic analysis, financial systems design, and internal controls. In addition to commercial clients, I have a number of government clients including the FBI, U.S. Army, Selective Service System, and the Department of Commerce. I have assisted a number of Federal agencies in implementing the Federal Managers' Financial Integrity Act of 1982.

I am appearing before you today to report the results of our independent analysis regarding certain aspects of S. 1680, the Malt Beverage Interbrand Competition Act. Our work was sponsored by the National Beer Wholesalers Association.

Retail Beer Prices

During previous testimony on this legislation, it has been stated by some of those opposed to the legislation that in Indiana the retail price of beer dropped 20% after exclusive wholesale territories were outlawed.

It was suggested that the 20% figure was based on a "study" done by/for an Alcoholic Beverage Commission Study Committee of the Indiana Legislature in 1981. We have checked directly with those involved with the Committee, including Committee members,

and have determined that such a study was not performed. Rather, a person appearing before the Committee to describe the historical background of the alcoholic beverage industry in Indiana said that the effect of retail hauling on the price of beer was a reduction of approximately 20% on the wholesale and retail price.

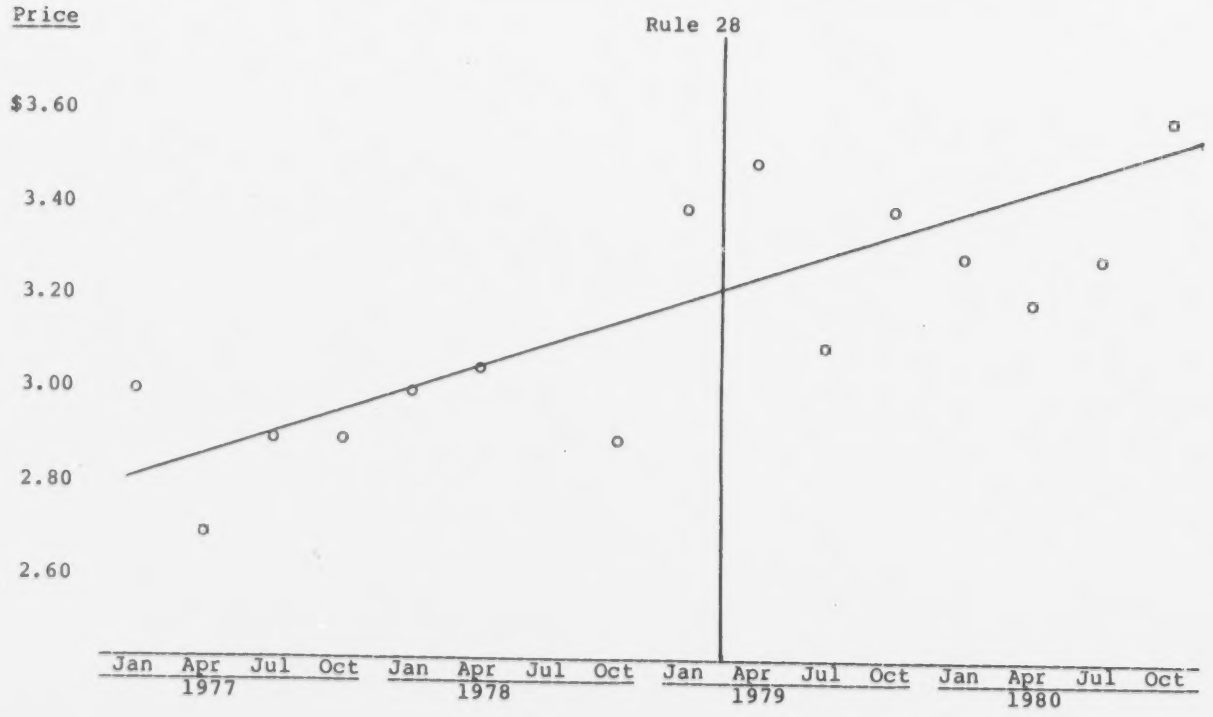
We analyzed available retail beer price data in Indiana. Retail price information was used because that is the price paid by the consumer. In one analysis we focused on any discernable retail price patterns relating to the enactment of Rule 28 in 1979. In developing this data we reviewed beer advertisements in Indiana newspapers. Transshipping began in 1973/1974, so we sampled Indianapolis and South Bend newspapers back to that date; however, beer advertising was not permitted in Indiana until 1977. We were able to develop a trend of retail prices in Indianapolis by sampling beer sale prices in the first week of each quarter. In South Bend no beer was advertised with sufficient frequency to establish a price pattern.

The results of this survey are displayed in Exhibit I; the heavy vertical line in the middle of the chart denotes the effective date of Rule 28. The exhibit presents the results for all beers advertised during the period, with the trend line representing the median retail price of beer. The price curve shown in the figure closely parallels the overall CPI data for beer over the same period. We point out that over the past 15 years the overall CPI has increased substantially faster than the beer component of the CPI. The chart in the appendix shows how much faster the overall CPI has risen.

The exhibit clearly shows that there is no noticeable change in the retail price of beer associated with the imposition of Rule 28; certainly nothing in the range of the reported 20% drop.

Exhibit I

MEDIAN PRICE OF 12 PACKS OF BEER ON SALE IN INDIANAPOLIS, 1977 - 1980



Unfortunately, data do not exist to extend the curve back to the 1973-1974 time frame when transshipping began.

A study commissioned by the soft drink industry several years ago deals with the probable effect of transshipping on that industry. Without going into detail, we can repeat the conclusion of that study: transshipping, together with legal abolition of exclusive territories, would drive many bottlers and distributors out of business, degrade the quality of soft drink products, and ultimately force up the price to the consumer.

We also compared retail beer prices in Indiana with those in other states, using price data collected by a national market research organization in November/December 1981 (the most recent period for which complete data was available) in selected metropolitan areas. Prices in the survey contained both state and local taxes. We have factored out state taxes including excise taxes, which vary substantially from state to state; local taxes vary over a small range, so we did not adjust for them.

In doing this analysis we determined that, in 1981, 16 states had a statute or statutes which mandate exclusive territories:

States with Exclusive Territories

Hawaii	North Carolina
Illinois	North Dakota
Kansas	Ohio
Maine	Pennsylvania
Maryland	South Carolina
Michigan	Tennessee
Montana	Vermont
New Hampshire	West Virginia

Since 1981, three states (Georgia, Kentucky, and Oregon) passed exclusive territory legislation.

Exhibit II arrays the retail price data by city: the prices are shown in descending order; the column on the right indicates whether the state mandated exclusive territories at the time the pricing data was collected.

The table clearly indicates that:

- The retail price of beer in Indianapolis is not lower than all other areas.

- The existence of exclusive territories does not mean that the retail price of beer will be high.

NBWA commissioned an independent study to determine the retail price of beer in several cities in Indiana, and the neighboring states of Kentucky and Illinois. (Indiana is the only state prohibiting exclusive territories; Kentucky recently passed a law requiring such territories; and Illinois has had such a statute for many years.) In the study, a large number of retail establishments in each state (e.g., over 500 in Indiana) were visited to determine the retail price of various beers. The results of this study are summarized in Exhibit III.

The table shows that the relationship of retail beer prices among Indianapolis, Chicago, and Louisville is roughly the same as shown in Exhibit II with Chicago prices generally lower than those in Indianapolis and Louisville prices higher.

The lower portion of Exhibit III shows the detailed retail price information developed in the study. The average price for each city is shown as well as an average price for each state. The average state price was computed from the detailed data and is not the average of city prices. Also nothing was weighted to account for the volume of beer sold.

Exhibit II

COMPARATIVE RETAIL BEER PRICES IN SELECTED MAJOR MARKETS

City	Nov/Dec 1981 Prices* (W/O Tax)	1981 State Statutes**
Atlanta	$3.07	
Portland	2.96	
Seattle	2.81	
Michigan	2.80	Exclusive Territory
Houston	2.70	
New York	2.68	
Oklahoma City	2.62	
St. Louis	2.59	
Charleston/Huntington	2.59	Exclusive Territory
Louisville	2.56	
Dallas/Fort Worth	2.55	
Cleveland	2.54	Exclusive Territory
Phoenix	2.54	
Indianapolis	2.52	(Rule 28)
San Francisco	2.50	
Omaha	2.50	
Charlotte	2.50	Exclusive Territory
Chicago	2.49	Exclusive Territory
Denver	2.48	
Kansas City	2.41	
Los Angeles	2.40	
Pittsburgh	2.32	Exclusive Territory
Minneapolis	2.10	

* Average price of two major brands of six packs of cans. This is the latest pricing data available for all of these markets; later data omits key cities such as Indianapolis, so 1981 was used.

** Statutes mandating exclusive territories have become effective since 1981 in some of these states, including Georgia, Kentucky, and Oregon.

Exhibit III

RETAIL BEER PRICE SURVEY IN INDIANA, ILLINOIS AND KENTUCKY

	Brand of Beer			
	A	B	C	D
City				
Indianapolis	$2.00	$2.58	$2.84	$2.60
Chicago	1.82	2.46	2.86	2.49
Louisville	1.84	2.80	3.21	2.86
State/City Prices				
Indiana (avg.)	$1.84	$2.50	$2.76	$2.48
Evansville	1.56	2.42	2.72	2.30
Fort Wayne	1.70	2.38	2.70	2.38
Gary/Hammond	2.00	2.42	2.76	2.46
Indianapolis	2.00	2.58	2.84	2.60
South Bend	1.78	2.44	2.66	2.40
Bloomington	1.90	2.56	2.74	2.46
New Albany	1.70	2.66	3.04	2.64
Terre Haute	1.74	2.60	2.94	2.60
Illinois (avg.)	1.85	2.60	2.94	2.66
Chicago	1.82	2.46	2.86	2.49
Peoria	1.90	2.83	3.11	2.93
Kentucky (avg.)	1.86	2.80	3.19	2.85
Lexington	1.90	2.80	3.16	2.84
Louisville	1.84	2.80	3.21	2.86

Note: The average prices shown for the states are averages of all observations in the state, not weighted averages of city prices.

As can be seen in the table:

- The retail price of beer is generally lower in Indiana cities other than Indianapolis, the center of transshipping.

- The price of retail beer in Peoria is much higher than the price of beer in Chicago.

- The average retail beer prices found in eight Indiana cities is lower than the average for two cities in Illinois and in Kentucky.

General conclusions which emerge from the foregoing findings include:

- Far from leading to a 20% decrease in Indiana retail beer prices, Rule 28 had no effect whatever.

- Insofar as the retail price in major metropolitan areas is a true measure of state retail prices, no pattern of higher pricing appears associated with territorial restrictions. To the extent that Indianapolis mirrors Indiana -- and Indianapolis is a center of transshipping in the state -- it stands only slightly below the middle in price: 13 cities in the survey have higher prices, while nine have lower.

- Retail beer prices in Indiana are lower than those in Kentucky and Illinois as measured by the average price found in selected cities. If these averages were computed with a weighting factor to account for total sales in the given cities, then the retail price of beer in Illinois would likely be lower. It is difficult to

draw an overall conclusion as to current retail beer prices except to say that Indiana prices are not markedly lower.

Wholesale Concentration

We analyzed available data in the beer wholesale industry that can be used as indicators of concentration at the state level. This data was combined with data regarding those states which operate with exclusive territories and with available pricing data in order to identify any patterns.

In order to completely assess the impact of exclusive territories on wholesale concentration, it would be necessary to examine data for individual markets. Such local market data is not readily available, particularly at the brewer/brand level.

In the absence of information on local markets, data on wholesaler concentration on the state level was developed from the "Beverage Data Bank" maintained by the Beverage Marketing Corporation. Based on this data, states where fewer than ten wholesalers controlled 30% or more of the market were identified. These states, the number of wholesalers, and their combined market shares are shown with Exhibit IV. The table also identifies those states which operate with exclusive territories. As shown in the table, eight of the 21 states and the District of Columbia, where wholesaler concentration is such that fewer than ten wholesalers control more than 30% of the market, operate with exclusive territories. In the other 14 states, exclusive territories do not prevail.

In Exhibit V, the nine states which have fewer than ten wholesalers controlling 50% or more of the market are identified. The states are grouped into those that have exclusive territories

Exhibit IV

STATES IN WHICH LESS THAN TEN WHOLESALERS
HAVE 30 PERCENT OR MORE OF TOTAL BEER SALES

States	Number of Wholesalers	Percent of State Sales	Exclusive Territory
Alabama	9	44	
Colorado	5	39	
Connecticut	4	56	
Delaware	2	68	
District of Columbia	4	86	
Florida	9	36	
Georgia	4	30	Yes
Hawaii	6	70	Yes
Kansas	6	45	Yes
Kentucky	4	30	Yes
Louisiana	7	41	
Maryland	6	42	Yes
Missouri	9	48	
Nebraska	7	44	
Nevada	8	69	
New Hampshire	7	63	Yes
New Mexico	6	53	
Oklahoma	8	43	
Rhode Island	5	75	
South Carolina	9	40	Yes
Tennessee	8	47	Yes
Utah	4	65	

TOTALS: 8 With Exclusive Territories
14 Without Exclusive Territories

Exhibit V

STATES IN WHICH LESS THAN TEN WHOLESALERS HAVE
50 PERCENT OR MORE OF TOTAL BEER SALES

Exclusive Territory States	Non-Exclusive Territory States
Hawaii	Connecticut
New Hampshire	District of Columbia
	Nevada
	New Mexico
	Rhode Island
	Utah

and those that do not. As indicated on the table, there are two states with exclusive territories and seven without exclusive territories.

As shown by the tables, exclusive territories do not lead necessarily to market concentration - about a third of the states with fairly high market concentration have exclusive territories and two-thirds do not.

We then correlated the data on wholesaler concentration (fewer than ten wholesalers controlling 30% or more of the market) and available retail prices of beer. Price information was available for seven of these states and is shown in Exhibit VI. Included in the table are the concentration data from Exhibit IV, and an identification of whether exclusive territories are effective in those states. As can be seen in the table, the highest, the median, and lowest prices occurred in exclusive territory states. Also, these states with high wholesale concentration cover most of the range of retail prices presented in Exhibit II.

Based on these findings, the following conclusions can be drawn regarding concentration in wholesale beer sales:

- There is no evidence that exclusive territory restrictions will result in higher wholesaler concentration. As shown, 14 of the 21 states and the District of Columbia with high wholesale concentration do not have exclusive territories. In the 29 states which are not included in the high concentration category, 11 operate with exclusive territory statutes and 18 operate without them.

- The retail price of beer is not higher in those states with a higher degree of concentration and exclusive territories.

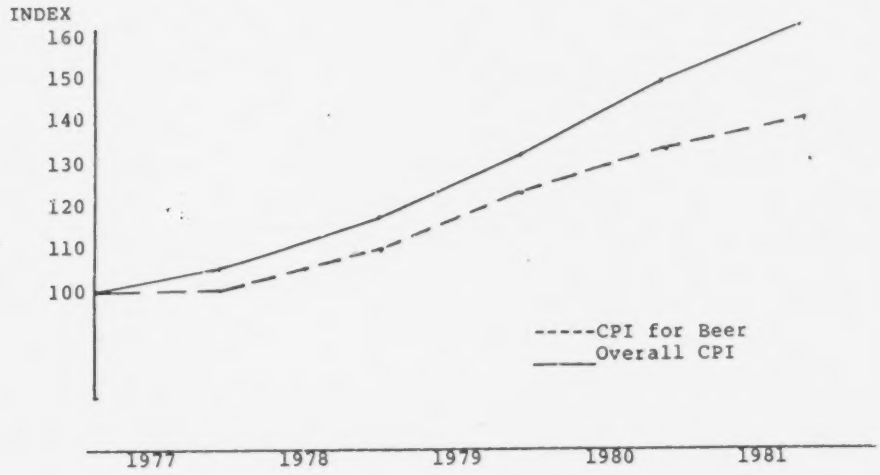
Exhibit VI

RETAIL BEER PRICES IN SELECTED MARKETS IN STATES IN WHICH FEWER THAN TEN WHOLESALERS HAVE 30 PERCENT OR MORE OF TOTAL BEER SALES

State	Number of Wholesalers	Percent of Market	Retail Price in a Selected Market		Exclusive Territories
Georgia	4	30	Atlanta	$3.07	Yes
Oklahoma	8	43	Oklahoma City	$2.62	No
Missouri	9	48	St. Louis	$2.59	No
Kentucky	4	30	Louisville	$2.56	Yes
Nebraska	7	44	Omaha	$2.50	No
Colorado	5	39	Denver	$2.48	No
Kansas	6	45	Kansas City	$2.41	Yes

APPENDIX

OVERALL CPI GROWTH COMPARED TO BEER PRICES



Mr. CANNON. Thank you, Mr. Willett. The committee will be sending you some questions also.

If there is nothing further, the hearing is adjourned.

[Whereupon, at 12:10 p.m., the committee was adjourned, subject to the call of the Chair.]

THE MALT BEVERAGE INTERBRAND COMPETITION ACT—S. 1680

TUESDAY, MAY 22, 1984

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senator DeConcini.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order.

Today, the committee continues its consideration of S. 1680, the "Malt Beverage Interbrand Competition Act." Essentially, this legislation would permit the establishment of exclusive territories for the distribution of a malt beverage product when such product is in substantial and effective competition with other malt beverage products.

Proponents of this legislation argue that it will have procompetitive effects and ultimately benefit consumers. Opponents of S. 1680 argue that consumers will be adversely affected and that our current antitrust laws regarding the nonprice vertical restraints are sufficient.

To follow up on the committee's first hearing on S. 1680, we have assembled a distinguished group of witnesses today, and I look forward to hearing their testimony.

I can stay here until about 10:35 at which time I will have to leave for another appointment, but we hope to have another Senator here to carry on by then.

Senator DeConcini's statement will appear in the record without objection at this point.

[The following was received for the record:]

PREPARED STATEMENT OF SENATOR DENNIS DECONCINI ON S. 1680, THE MALT BEVERAGE INTERBRAND COMPETITION ACT, MAY 22, 1984

Mr. Chairman, I would like to thank you for scheduling and holding these hearings today on S. 1680, the Malt Beverage Interbrand Competition Act. I am glad to have this opportunity to hear the testimony of our witnesses and to further explore the important issues that are raised by this bill, and I appreciate the Chairman's cooperation and concern in having today's hearings.

I am, of course, a supporter of S. 1680, which currently has 35 cosponsors in the Senate. This bill is, I believe, a necessary and justifiable clarification of the antitrust laws as they apply to the Malt Beverage Industry. It will set a clear and con-

cise standard for determining the legality of vertical non-price restrictions on the distribution of malt beverages.

The provisions of S. 1680 are narrow and precise. Section 2 provides that nothing in our Federal antitrust laws shall render unlawful written agreements between brewers and wholesalers which give the wholesaler the exclusive right to sell a particular brand of malt beverage within a specified territory, provided that, in the words of Section 2, "such product is in substantial and effective competition with other malt beverage products within that defined geographic area." It is important to note that such territory restrictions are nothing new; they have been the operative norm in this country for the last 50 years. This bill would simply preserve the highly competitive system of beer distribution that has served the consumer well all these years.

Equally important is what S. 1680 would not do. It would not change the current prohibitions against price-fixing, horizontal restraints of trade, and group boycotts, if such arrangements would otherwise be unlawful. It would not remove the right to recover treble damages for injuries resulting from exclusive territorial arrangements that do not meet the bill's requirements. S. 1680 also would not require brewers or wholesalers to enter into territorial agreements. Rather, it merely states that if substantial and effective interbrand competition exists within a defined geographic area, then such territorial agreements are not prohibited by Federal antitrust laws. Finally, Section 7 of S. 1680 provides that nothing in the bill will invalidate or affect the existing power of the states to regulate the distribution and sale of malt beverages.

The healthy competitive effects of certain territorial arrangements were acknowledged by the Supreme Court in its decision in the *GTE Sylvania* case. These benefits have been present in the territorial distribution systems which have typified the malt beverage industry ever since prohibition, and which have ensured healthy, vigorous interbrand competition in the beer industry. This bill would simply maintain that distribution system, while eliminating the current confusion and uncertainty that exist under the "rule of reason" standard that is applied to such cases.

Let me again thank the distinguished Chairman for having these hearings today, and thank the witnesses for their appearance and participation.

The CHAIRMAN. We have several witnesses here this morning from South Carolina. Mr. R. Roy Pearce of Columbia, chairman of Budweiser of Columbia, Greenville, Anderson, and Spartanburg, on behalf of the National Beer Wholesalers' Association.

We have the Honorable E.W. Cromartie II, Columbia, SC, on behalf of the National Beer Wholesalers' Association.

We are very pleased to have you gentlemen here. They are both very prominent people. Mr. Pearce was a star football player on that Clemson team years ago, and he is one of the outstanding businessmen of Columbia.

Mr. Cromartie is a very outstanding gentleman in Columbia, a member of the city council there, and we are very pleased to have you gentlemen here.

Mr. Price we are glad to have you with us. Mr. Price is a very prominent citizen in our State, and he is accompanying these other two witnesses, who will testify.

So we will be pleased to hear from you now, Mr. Pearce or Mr. Cromartie, whichever one wants to go first.

STATEMENT OF A PANEL CONSISTING OF R. ROY PEARCE, CHAIRMAN, BUDWEISER OF COLUMBIA, GREENVILLE, ANDERSON, AND SPARTANBURG, COLUMBIA, SC, ON BEHALF OF THE NATIONAL BEER WHOLESALERS' ASSOCIATION, INC., AND HON. E.W. CROMARTIE II, COLUMBIA, SC, ON BEHALF OF THE NATIONAL BEER WHOLESALERS' ASSOCIATION, INC., ACCOMPANIED BY L.L. PRICE, PRESIDENT, BUDWEISER OF COLUMBIA, INC.

Mr. PEARCE. Thank you very much, Senator.

My name is R. Roy Pearce from Columbia, SC, and my company has been in the distribution business of Anheuser-Busch products for over 50 years.

When we originally started, Senator, in our business and had a beer territory assigned by Anheuser-Busch, it was on a car-to-car basis. You had nothing in writing, no assurance of the territory, no assurance of the business.

Later when the brewery requested us to do certain things, they came with an equity agreement and developed territorial assignments to insure continuity of operations. This has enabled us in South Carolina to develop full operations with over 252 South Carolinians being employed.

In its wisdom last year, the South Carolina Governor, the General Assembly, the South Carolina Tax Commission and the ABC Commission wanted and passed territorial legislation. The Governor, the General Assembly, the Tax Commission, and the ABC Commission enthusiastically supported the new territorial law.

It might be of some interest to you, Senator, that Mr. Marion Carnell, who has an exclusive distributorship of Pigley-Wigley in his town, was one of our proponents.

We recognize that the South Carolina law cannot guarantee this territorial assignment because it can be overturned by the Federal courts, but we strongly support S. 1680 because the Congress would speak out and say that what the State has done is legal, if the business is still competitive.

We are not asking Congress to set up territorial exclusive territories, but we want them to allow us, and our State to pass territorial laws. One brewery, who has equity agreements with their distributors, can then count on and depend on this type of continuity so we will be able to make the commitment the State expects us to make, and the brewery wants us to make in the way of capital improvements.

In our small operation in Columbia, sir, we have over $1 million in building and over $1 million in rolling stock, trucks, and delivery equipment. We have nearly one-half a million dollars in forklift trucks, refrigeration equipment to make sure we comply with brewery requirements.

Now, we have other commitments we must make, but it is very difficult for us to commit millions of dollars to additional capital improvements to expand our business, to hire and retain more people in South Carolina to work if we have no assurance that our territorial rights will be protected.

Keep in mind, sir, that the beer business is not like any other business. It's a very tough regulatory environment in which we

work. The Federal Government, the State government, the ATF, the ABC, they're all controlling our destiny.

In my food business that I ran for 39 years, sir, I had no controls of that type. I could do pretty well as we pleased as long as we stayed within the parameters of the general free enterprise system.

You cannot do that in the beer business. It is a very highly controlled business.

The present territorial agreement, Senator, encouraged by the State of South Carolina, is giving the South Carolina consumers in our marketing areas the best value, the best prices, the most competitive situation that we have ever seen in the beer industry since I have been in it for over 40 years.

Transshipping or cherry-picking by outsiders coming in, it could hurt us very badly. We do not have this situation yet in South Carolina. We do not know that we will have. But we can have it, sir, because it has happened elsewhere, and if it does happen, we will be in severe trouble.

The State of South Carolina law, which could be overruled by the Federal courts, of course, says that every wholesaler must work on a regular basis every licensed retailer in his territory on a weekly basis.

A cherry-picker or a transshipper comes in, loads the truckload of beer, goes to a large retailer, dumps the beer off, does not call on our small business people who need this type business to help them survive.

We have effective and aggressive competition. If you do not believe that, I want you to hear from one of our very fine citizens of South Carolina who will make a presentation to you, sir, and this committee, and he will let you know what could happen to the small businessman who finds that our type service and our type product is so important to him.

At the conclusion of his testimony, Mr. Chairman, I have with me Mr. L.L. Price, who is president and chief executive officer of our company, probably the most outstanding beer distributor management man in the Southeast, maybe the country.

But at this time, I would like to have Mr. E.W. Cromartie, a member of Columbia City Council, and owner of a small business, who does sell our product and is a retailer, make his presentation.

[The following was received for the record:]

TESTIMONY OF

R. Roy Pearce, Chairman

Budweiser of Columbia Budweiser of Anderson

Budweiser of Greenville Budweiser of Spartanburg

Before the

COMMITTEE ON THE JUDICIARY, UNITED STATES SENATE

May 22, 1984

Mr. Chairman, distinguished members of the Committee, thank you for the opportunity to appear before you today. I am R. Roy Pearce, and I speak in support of the proposed Malt Beverage Interbrand Competition Act (S.1680).

Mr. Chairman, I am the chairman of four malt beverage distributorships in South Carolina -- Budweiser of Columbia, Budweiser of Anderson, Budweiser of Greenville, and Budweiser of Spartanburg. For more than fifty years, I have been proud to represent Anheuser-Busch Brewers of St, Louis, Missouri in South Carolina. I'll represent them for another fifty years if I last that long.

After all those years of practice, I know the beer business in South Carolina. I think I understand the beer business nationwide. With your permission, Mr. Chairman, I'd like to share some of that knowledge with this committee.

Over the years, I have worked closely in cooperation with South Carolina's governors, the South Carolina Legislature, the South Carolina Tax Commission, the South Carolina Alcoholic Beverage Control Commission, and the federal Bureau of Alcohol, Tobacco, and Firearms. It is my duty as a corporate and private citizen to adhere to all the laws and regulations affecting the distribution of malt beverages. I might add Mr. Chairman, in the food distribution business, which I was associated with for over forty years, we have no federal or state controls as we do in the beer business. These rules are designed to protect the citizenry, facilitate the collection of malt beverage excise taxes, and ensure that beer remains the beverage of moderation for working men and women of South Carolina.

Mr. Chairman, over the years South Carolina's laws have evolved as practice and insight exposed the best methods of control and distribution of malt beverages. That evolutionary process reached a pinnacle in May of 1983, when the South Carolina Legislature -- with recommendations and support from the Tax Commission, the ABC Commission, the Governor;s Office, and the South Carolina Beer Association -- passed the new Beer Territory Law. This law insures the preservation of the highly competitive wholesale distribution system and the continuity and survival of thousands of small retail merchants who are served by these wholesalers. The Legislature's wisdom rests in its realization that territorial designations afford the most effective, efficient, and competitive malt beverage distribution and service. The benefits of this method accrue to brewers, retailers, government regulators, tax collectors, and, most important, consumers.

The territorial system is effective because it designates areas of responsibility. Responsibility is the key word here. When a wholesaler is designated to be the sole distributor of a brewery's products for a specified geographic area, he or she assumes obligations to the brewery. In my case, the brewery is Anheuser-Busch. My franchises contract with A-B requires me to service all legal retail outlets in my territory. All retail outlets, whether they buy one case or a thousand. In my brewery-assigned territories, there are 3,788 licensed retail accounts. More than 3,000 of these accounts are small independent retail outlets that require and need regular, dependable wholesaler service. I provide that service whether it is profitable or not.

Service to retailer does not stop at delivery. Beer is a perishable commodity, and it is the responsibility of the wholesaler to represent the brewery and make absolutely sure that no stale or old beer is sold in his assigned territory. The wholesaler must rotate the stock and replace any old or damaged product at his own expense. The brewery polices its wholesalers to ensure compliance. If old or damaged product is found in the territory, the designated wholesaler is held accountable. Thus, the system has safeguards to protect the brewery, the retailer, and ultimately, the consumer.

Territories of responsibility entail wholesaler accountablility to the state government as well. The wholesaler must keep meticulous records of inventory and sales in his assigned area. These records aid the state in its collection of taxes and control of alcoholic beverages. Should any irregularities occur, the state knows exactly who to contact. If a brand of beer came into an area from several different distributors, it would be much more difficult to control the product and collect all applicable tax revenues.

Finally, exclusive territories for the distribution of malt beverages ensure responsible service and competitive prices for the working men and women of South Carolina. Territories guarantee vigorous interbrand competition. Just as it is the responsibility of the wholesaler to serve all accounts within his assigned territory, it is his responsibility as good businessman to provide the best possible service to a retailer at the lowest possible price. How else is a wholesaler to compete for market share if he fails to keep prices low?

Mr. Chairman, in South Carolina, as in the rest of the nation, brewers and wholesalers are in a tooth-and-nail struggle for more retail customers. This competition pits Budweiser against Miller, Strohs, Coors and all the rest. As a Budweiser distributor, my pride and my livelihood depend on my ability to make Budweiser the best selling beer in Columbia, Anderson, Greenville, and Spartanburg. Being the only Budweiser distributor in those geographic areas does not diminish my work-load one iota. There are Stroh wholesalers, Miller wholesaler, Coors wholesalers, Falstaff wholesalers, and a bunch of other guys who want to be number one just as badly as I do.

In fact, Mr. Chairman, there are more that seventy different varieties of both domestic and imported beer competing in our territories in South Carolina. Since passage of the Beer Territories statute, South Carolina has seen unequaled vigorous competition. For the life of me, Mr. Chairman, I can't understand why anyone would say that exclusive territories create monopolies and lead to higher prices. If I have a monopoly, no one bothered to tell the competition that. I still have to get up early every day to face the rigors of the marketplace.

In short, Mr. Chairman, the territorial provisions of South Carolina law have helped to increase competition at all levels. They have helped the beer industry, and numerous state and federal agencies, to identify and maintain wholesaler responsibilities. They have provided retailers and consumers the widest variety of choice among competitively-priced malt beverage products. South Carolina's system demands the best of the small businessmen who engage in wholesale beer distribution. The citizens of South Carolina deserve nothing less.

Mr. Chairman, members of this distinguished committee, my brewery recognizes territorial rights, the State of South Carolina recognizes territorial rights, twenty-two other states mandate territorial rights by law, and I believe it absolutely essential that the federal government recognize these territorial rights if our competitive industry is to survive. The Malt Beverage Interbrand Competition Act would codify this necessary federal recognition.

The Malt Beverage Interbrand Competition Act would not exempt beer wholesalers from antitrust law, as some have alleged. It would simply clarify the fact that an exclusive territorial agreement between a brewer and a wholesaler is not by itself a violation of the law. The Supreme Court in Contenential TV v. GTE Sylvania determined that such territorial agreements often foster interbrand competition. The federal government must realize that the malt beverage industry runs on interbrand competition, and that the conditions applicable in the Sylvania case are equally appropriate for the beer industry. The federal government must recognize that the malt beverage industry is not like other industries we are closely controlled and watched (regulatory environment).

Mr. Chairman, the Malt Beverage Interbrand Competition Act is also necessary to preserve the intent of the South Carolina Legislature's Beer Territorial Law. A new element has entered the beer distribution system that could cause irreparable damage to the small retailers and the beer wholesalers of South Carolina. It is called transshipping, and it undermines both State control of malt beverage products and the intrinsic fairness of the territorial distribution system. Today, in some states, transshipping "Super Wholesalers" are, crossing territorial lines assigned by breweries and selectively servicing the largest accounts in a market while not servicing the small independent retailer who must have regular

wholesaler service to survive. The transshipper can offer tractor-trailer loads of beer at a discount because he incurs none of the true costs of servicing the territory. He does nothing to promote the products he sells. He does nothing to service the retailers he call on. All he does is drop off huge quantities of beer ar prime locations -- thumbing his nose at the small businessman who has struggled and invested to develop his market, and neglecting the independent retailer who cannot afford to buy a truck-load at a time. When transshipping takes over, the brewery suffers because it has lost control over the quality of product and the image of its representatives who service an area. The State suffers as tax collection and control of alcoholic beverages becomes more difficult. The retailers suffer because only the largest outlets can take advantage of the volume discounts. And finally, the consumers suffer as quality control slackens and choice among brands wanes. The transshipper disregards the brewer under the theory that enforcement of the territorial restraints creates an antitrust problem.

Mr. Chairman, South Carolina law is wise in its foundation and practical in its implementation. It provides for close and accurate controls over the beer industry by both federal and state regulatory agencies and has resulted in increased revenues for those agencies. The proof of the pudding indeed.

Mr. Chairman, regardless of the wisdom of South Carolina's leadership and the 21st Amendment to the U.S. Constitution, South Carolina's malt beverage laws can be challenged under federal antitrust law, which, in spite of enormous evidence to the contrary, have been interpreted as including such agreements and laws as possible antitrust violations. The issue before this committee is fundamental: Does the federal government wish to recognize the existence of a territorial system that has served this nation efficiently for more than 50 years? The Malt Beverage Interbrand Competition Act gives Congress that opportunity. I pray you will take it.

Thank you.

The CHAIRMAN. Mr. Cromartie, we are glad to have you with us, and you may proceed now.

Mr. CROMARTIE. Thank you, Senator.

Mr. Chairman, distinguished members of the committee, it is an honor to be here to testify before you on behalf of the Malt Beverage Interbrand Competition Act. I am E.W. Cromartie II. I own Cromartie's, a small independent convenience store, and am a member of the City Council of Columbia, SC.

In my business, malt beverages are an essential commodity. They constitute an important part of my sales and, hence, my livelihood. For that reason, I pay close attention to what happens in the beer market in South Carolina. I also watch marketing trends in other States.

What I have observed, Mr. Chairman, is both a cause for contentment and concern. On the one hand, South Carolina's laws have blended with an understanding of market forces to produce an effective three-tier system for the distribution of malt beverages. On the other hand, trends in New York and Indiana, where transshipping is rampant and chain stores are the sole beneficiaries of the chaos, show that the system is fragile and can be subverted. I do not wish to see that happen in South Carolina, Senator Thurmond. That is why I support the Malt Beverage Interbrand Competition Act.

During the years that I have been in business, and my family has been in business over 50 years, Senator, alcohol beverage business, and I have been in business over 2½ years in the malt beverage industry, I can say from experience that none are more active, attentive, and competitive than the beer distributors. I currently deal with eight beer wholesalers. They make regular deliveries. They rotate my stock. They clean my shelves, and they constantly compete for promotional space in my store. My local wholesalers also compete with pricing. They run specials from week to week that help me draw in my customers. That, of course, is good for all of us.

Mr. Chairman, as a sole proprietorship and as a small businessman, I am very satisfied with the performance of the three-tier system under exclusive territories. Since passage of the three-tier law and mandatory exclusive territory laws, service from the various distributors has been excellent. My customers have a wide selection of fresh malt beverages to choose from and prices have remained low. I think that is a pretty good record.

Some small retailers all over the State have benefited from the consistent service of the beer wholesalers. We have benefited because the territorial system makes allowances for small businesses.

Under the three-tier system, the brewery manufactures the beer. The wholesaler distributes it, and retailers sell it to the customers. Territory or franchise agreements between a brewery and its wholesale representatives stipulate that all potential retail outlets in an area ought to be serviced regardless of sales volumes.

Mr. Chairman, I am not so sure that this would happen in the areas of transshippers. In fact, wholesalers could lose money by serving some out-of-the-way mom-and-pop stores. Thus, wholesalers need the service and need the business of the large volume stores to make up for the cost of supplying the less profitable locations.

Territorial franchises ensure the economic viability of full service beer wholesaling. Small business and their clients are the beneficiaries. This is the system that is mandated by the laws of South Carolina and which the Malt Beverage Interbrand Competition Act seeks to preserve.

The alternative which would result from a failure to pass this measure is the destruction of that system and the eventual domination of the market by a handful of high volume stores which will water only to the needs of the largest supermarket chains and result in the destruction of the small business stores.

Mr. Chairman, transshippers can afford to ignore the needs of the independent food stores, the local bar or restaurant, and the small retail outlet as they focus on realizing maximum profits from large-lot customers. By cornering the supermarket trade, they cause the local wholesaler to be cut off from his major source of income, thus making it impractical to attempt to continue to serve the small nonchain retailer outlet.

Mr. Chairman, the only one to benefit from this situation is the large grocery chains and the few transshippers who service them with large supplies of a few brands of beer. Placed at a potentially insurmountable disadvantage is today's entire structure of small brewers, local wholesalers, operators of small retail stores, and, of course, the consumer.

In the South Carolina market, there are 488 ethnic accounts, 798 convenience stores. My business, Cromartie's Party Shop, is one of those accounts. We employ six to eight full- and part-time employees. Some of these employees are female, unmarried, and have children. If transshippers were allowed, small businesses would not be able to purchase in carloads, truckloads, or even 1,000 cases of beer at a time, while the large food chains will be able to purchase maximum sales. We would not be able to compete. It would not be economically feasible and as a result, we would go out of business.

Those employees whom I employ currently who are off the welfare roles because of the employment would then be back on the welfare rolls because we would have to go out of business.

This is something that I know you do not want, Senator Thurmond, and of course, this is what we do not want in the State of South Carolina or throughout the Nation.

The legislation before this committee will not change laws in other States nor would it supersede any other State's regulation. What it would do is to help preserve the system that has evolved in States like South Carolina, Georgia, and Alabama, a system mandated by law in 22 States and practiced in 26 others. That is the territorial retail system for the distribution of beer.

For more than 50 years, it has earned the support of small businesses across this country. It deserves the support of this Congress. The people of South Carolina want this system and they want it protected from unwarranted attacks.

I know Congress and I know, Senator Thurmond, that you want to protect the small business people in the State of South Carolina and throughout America. I sincerely hope this committee will send S. 1680 to the floor of the Senate with a strong recommendation for passage.

Thank you, Senator.

[The following was received for the record:]

TESTIMONY OF
E.W. Cromartie II
Before the
COMMITTEE ON THE JUDICIARY, UNITED STATES SENATE
May 22, 1984

Mr. Chairman, distinguished members of the Committee, it is an honor to be here to testify before you on behalf of the Malt Beverage Interbrand Competition Act (S.1680). I am E.W. Cromartie. I own Cromartie's, a small independent convenience store, and am a member of the City Council of Columbia, South Carolina.

In my business, malt beverages are an essential commodity. They constitute an important part of my sales and, hence, my livelihood. For that reason, I pay close attention to what happens in the beer market in South Carolina. I also watch marketing trends in other states.

What I have observed, Mr. Chairman, is both a cause for contentment and concern. On the one hand, South Carolina's laws have blended with an understanding of market forces to produce an effective three-tier system for the distribution of malt beverages. On the other hand, trends in New York and Indiana -- where transshipping is rampant and chain stores are the sole beneficiaries of the chaos -- show that the system is fragile, and can be subverted. I do not wish to see that happen. That is why I support the Malt Beverage Interbrand Competition Act.

Mr. Chairman, during the years that I have been in business I have worked with all kinds of distributors. I can say from experience that none are more active, attentive, and competitive than the beer distributors. I currently deal with 8 beer wholesalers. They make regular deliveries, they rotate my stock, they clean my shelves, and they constantly compete for promotional space in my store. My local wholesalers also compete with pricing. They run specials from week to week that help me draw in more customers. That, of course, is good for me and it is good for my customers.

Mr. Chairman, I am very satisfied with the performance of the three tier system under exclusive territories. Since passage of the three tier law and mandatory exclusive territories law, service from the various distributors has been excellent, my customers have a wide selection of fresh malt beverage products to choose from, and prices have remained low. That is a pretty good track record, and it is not limited to my store.

Small retail merchants all over the state have benefitted from the consistent service of the beer wholesalers. We have benefitted because the territorial system makes allowances for small business.

Under the three tier system, the brewery manufactures the beer, wholesalers distribute it, and retailers sell it to the consuming public. Territorial franchise agreements between a brewery and its wholesale representative stipulate that all potential retail outlets in an area are to be serviced regardless of sales volume. As a

businessman, I understand that it costs money to deliver beer to a retailer and service his store. Profitability is determined by volume. In fact, a wholesaler could lose money by servicing an out-of-the-way "Mom and Pop" grocery or even an independent store like mine. Thus, wholesalers need the business of the large volume stores to make up for the costs of supplying the less profitable locations. Territorial franchises ensure the economic viability of full-service beer wholesaling. Small businesses and their clients are the beneficiaries. This is the system that is mandated by the law of South Carolina and which the Malt Beverage Interbrand Competition Act seeks to preserve.

The alternative, which would result from a failure to pass this measure, is the destruction of that system and the eventual domination of the market by a handful of high volume, "free rider" beer wholesalers which will cater only to the needs of the largest supermarket chains. In the process, they would abandon the interests of the small retailers, and ultimately the consumer.

The "free rider," also known as transshippers, neither offers nor provides the services to the retailer that are needed to help sell the beer that is delivered, and which the local wholesaler must provide in order to retain a profitable string of satisfied customers.

Mr. Chairman, transshippers can afford to ignore the needs of the independent food store, the local bar or restaurant and the small retail outlet as they focus on realizing maximum profit from large lot customers. By cornering the supermarket trade, they cause the local wholesaler to be cut off from his major source of income, thus making it impractical to attempt to continue serving the small, non-chain retail outlet.

It is the customer who, in a relatively short time, begins to pay the price for this development by having the choice of retail outlets at which beer can be purchased narrowed progressively until it becomes available almost exclusively at the chain stores. When this occurs, the customer suffers in other ways -- selection is cut to a minimum, and he is at the pricing mercy of those outlets which then have a monopoly.

Mr. Chairman, the likelihood of this pattern has been clearly established in Indiana, the only state with a rule on the books prohibiting exclusive wholesaler territories. There, transshippers reduce the varieties of beer available to consumers by carrying 12 oz. cans from the five major brands only. The products of small brewers are all but ignored, as is the transportation of kegs and bottles which require more care.

Those small volume retail outlet owners who choose to buy from trasshippers in order to realize a cost benefit are forced, not only to select from a sharply curtailed list of varieties, but must order beer in lots to large for their turnover to justify. The result is the sacrifice of already limited space to the storage of a single brand that in time goes stale.

What the small retailer has purchased in exchange for a competitive price is a mechanism of forced sale of what eventually is stale beer, thus creating dissatisfied customers and the permanent loss of trade.

Mr. Chairman, the only ones to benefit from this situation are the large grocery chains and the few transshippers who service them with large supplies of a few brands of beer. Placed at a potentially insurmountable disadvantage, is today's entire structure of small brewers, local wholesalers, operators of small retail stores and, of course, the consumer. For example, the 7-11 chain of convenience stores is not opposed to this federal legislation and, in fact, is actively supporting passage of exclusive territorial legislation in the State of Florida.

Mr. Chairman, I do not believe that the Indiana administrators who banned exclusive territories bargained for the mess that resulted. I understand that Indiana's ABC commissioner has advocated the repeal of the rule prohibiting territorial franchises. But even chaos has its constituencies, so the question of beer distribution in Indiana has become a political football.

The legislation before this committee would not change the Indiana law, nor would it supersede any other state's regulations. What it would do is help to preserve the system that has evolved in States like South Carolina, Georgia and Alabama -- a system mandated by law in 22 states, and practiced in 26 others. That is the territorial three tier system for the distribution of beer. For more than 50 years it has earned the support of small businesses across this country. It deserves the support of Congress. The people of South Carolina want this system and they want it protected from unwarranted attack.

I sincerely hope that this committee will send S. 1680 to the floor of the Senate with a strong recommendation for passage.

Thank you.

The CHAIRMAN. Thank you, Mr. Cromartie.

Mr. PEARCE. Sir, we have with us Mr. L.L. Price, who I mentioned is probably one of the most knowledgeable beer distributors in this country, and any questions this committee might wish to ask pertaining to any aspect of our business or why we feel so strongly about this matter, we would certainly entertain any questions and try to answer them to your satisfaction.

DEFINING SUBSTANTIAL AND EFFECTIVE COMPETITION

The CHAIRMAN. Well, we have a few questions. Either you or Mr. Cromartie or Mr. Price can answer them, whichever you prefer. The first question is this: those in favor of this legislation have argued that it will eliminate the uncertainty of applying the *GTE Sylvania* rule of reason test to exclusive territorial arrangements.

Opponents, however, have argued that using the standard of substantial and effective competition will create even more uncertainty than *GTE Sylvania*. How would you define the meaning of substantial and effective competition?

Mr. PEARCE. Mr. Price, how about you answering that?

Mr. PRICE. Senator, in our marketplace today, and I have been in this game for 40 years, I have never seen it more competitive than it is today. We have over 80 brands of beer competing one with the other, and the marketplace is tough.

Many times in South Carolina beer is being sold at the retail level almost to the penny of what we sell it to them at the wholesale level, and I would call that tough competition.

We have, in South Carolina, four major distributors of beer in our marketing area and now all of the liquor distributors are bringing beer products and now are competing in the marketplace with us with the malt beverage along with, of course, the hard liquor.

The CHAIRMAN. How many different brands of beer are sold in our State?

Mr. PRICE. Senator, we have in our house eight brands of beer that are brewed by Anheuser-Busch. Of many competitors I would say there are probably 40 to 50 brands of beer in the marketplace today, imports and, of course, domestic products.

The CHAIRMAN. Now, let me ask you a simple question. Why do you feel that this law would help your company?

Mr. PRICE. Well, Senator, what it would do, it would preserve what we have had, we think, for 50 years, which has been good distribution. It affords the State, it affords the Federal Government an accurate way of recording the taxes and bringing about the system to a point that there is no question about it.

As Mr. Pearce indicated, it is a very highly regulated industry as it is. We are controlled by everybody. As one of our ABC commissioners said, next to the nuclear industry, he knows of no industry that is as controlled as this, the malt beverage industry, is.

Senator, under the law, if we have one change in stockholders, we have to report to the ATF any change in stockholder ownership of our business. To open up a branch, we have to be very closely scrutinized and checked out, each individual who has any owner-

ship whatsoever in the business. This is unheard of in any other type business in our area that we know of.

We also feel, sir, that this new transshipping, this is something that has just recently developed within the last 3 to 5 years. We never heard of that before until some of these larger distributors in the State of Indiana began to transship across State lines, across county lines, across territorial lines, and many of the wholesalers there have suffered irreparable damage.

SOUTH CAROLINA LAW

The CHAIRMAN. Now, South Carolina has a law similar to this I believe.

Mr. PRICE. Yes, sir.

The CHAIRMAN. Well, now, is that law working out satisfactorily?

Mr. PRICE. Senator, we see no difference right now since the law came into effect. The only thing is some of the breweries that might have like, and I am not calling names, but some of them have shipped across lines in South Carolina until this came along, until our law came along, and now those distributors are confined to their geographical boundaries, which has not done a thing in the world except bring about real strong competition, one of those being a popular priced beer which today is being sold cheaper than it was ever sold before in the history of that particular brewery.

The CHAIRMAN. Well, is your South Carolina law effective today?

Mr. PRICE. Yes, sir, it certainly is.

The CHAIRMAN. Well, now, if your South Carolina law is effective, why do you need a Federal law?

Mr. PRICE. Well, we need the Federal law, Senator, as Mr. Pearce said, to give the courts a base from which to make this decision, whether or not we have competition or whether we do not.

It will not affect us. We have already passed that law in the State of South Carolina; your State and my State said we wanted it and we did want it. We have it. But other States have seen fit not to pass that law. They may or may not.

This law that we are asking for, S. 1680, will not grant exclusive territories as such, but it will give the courts that base that they need in making that decision about competition within that particular State and marketplace.

The CHAIRMAN. Now, Mr. Pearce's written testimony makes reference to the fact that transshipping distributors incur none of the costs of servicing a particular territory. In our last hearing, however, Mr. Richard Quinn, a transshipper from Indiana, testified that he was subject to the same brewery agreements as other Indiana wholesalers and that his contract required him to perform the same quality control functions.

How would you respond to Mr. Quinn's statement?

Mr. PEARCE. I do not know the gentlemen, sir, but I do not believe that his statement is accurate in every respect. Sir, I do not believe that this gentleman goes in weekly and services every account in the territory. I do not believe that he will make emergency calls on Saturday to service an account that needs servicing. I do not believe that he is picking up old beer and dumping it as we have to do.

I cannot refute his statement, Mr. Chairman, but I do question it severely.

Mr. CROMARTIE. Mr. Chairman, the only way that a transshipper can be effective to a businessman is to be available when necessary. That simply means thet when it is necessary to rotate our stock, he should be present. When it is necessary to have the promotional aspects of the business that these gentlemen provide twice a week in coming to the stores, providing the goods and services, being available when we need them so we can discuss a problem, at the same time make sure that our beer is fresh that is served there, the only way that can happen is they have to set up in the State of South Carolina just like these wholesalers would have to do.

And if they had to do that, they would then not have the low price, because they would have the same costs involved as these gentlemen do in the process of doing business. So it would be impossible for them to be in a position to have the same quality unless they were to come in with the same kind of operation.

Mr. PRICE. Mr. Chairman, that transshipper may do what he said. I do not know, as Mr. Pearce indicated, but I do know that he would not be calling on a Cromartie Party Shop or he would not be calling on a small independent grocer or he would not be calling on a small bar because of the volume that that particular bar would buy.

That particular guy would be dependent upon the local wholesaler who, at that point, would not be in a position to stay in business and would be out of business. So ultimately that guy would be in one heck of a position to find a product.

The CHAIRMAN. At our last hearing on this legislation, Professor Baxter, head of the Antitrust Division, made reference to the fact that in the malt beverage industry there was a pattern of several breweries appointing the same wholesaler to be their exclusive distributor, resulting quite often in very high levels of concentration at the wholesale level.

Do you know of any situations where this has occurred and what effect, if any, would this type of situation have in how S. 1680 would be administered by the courts?

Mr. PEARCE. Senator, I can answer this by giving you a perfect example. Last year, the Coors Brewing Co. of Golden, CO, moved into the Southeast with a very major effort for distribution.

They elected to go through already proven successful distributors. Throughout the United States over many years since prohibition many distributors have handled several different brands of beer.

In our individual case, we handle only one brand, manufactured and made by Anheuser-Busch. We do not handle any other brands. There are distributors that do handle other brands.

What this does, is to give the merchant a much more competitive situation. He has more opportunity to buy at better prices a larger variety of beers. So I do not think Mr. Baxter's statement is accurate, and if what he says is true, he is only saying that we are getting a more competitive situation than we have ever had before by good distributors having several fine brands of beer to sell.

Mr. PRICE. Mr. Chairman, to follow up what he said, the Coors distributors, when he started expanding his markets, he at first picked out major names of people and said, "I want you to be my distributor."

These totally failed and failed in the marketplace. They did not do the job. So they looked at that situation, and as Mr. Pearce says, they then decided to go with the already established distributors who had been in business for years, who had done a good job, who were very competitive in the marketplace, who knew the marketplace, and now they've been much, much more successful as they moved into the Southeast.

The CHAIRMAN. Now, both of you gentlemen who testified set forth numerous reasons in your written testimony why exclusive territories should be permitted. These reasons include proper servicing of small businesses, maintaining fresh beer for the consumer, and making State control and supervision easier.

Now, however, it seems that your legislation will not permit a court to consider these factors. Would you be better off if S. 1680 simply stated that exclusive territorial agreements between a brewer and a wholesaler is to be judged under the antitrust rule of reason?

Mr. PEARCE. Well, is it not a fact, sir, that if the bill passes as is that they could adjudicate the situation, depending on the competitive situation? We say this, too, Senator, we mentioned Coors a minute ago and this ties in with your question. Here in the depths of this legislation, in the middle of this legislation, here comes one of the toughest competitors we have ever had in our market. Under the new State law of South Carolina we have another competitor.

The consumer gets a better break, and the small business man has better control over what he is able to buy, and one additional point, that is in our testimony that is very, very important.

If we are the named distributor for Anheuser-Busch in a given territory and a transshipper ships in hundreds of cases or thousands of cases of beer to large retailers, we know that we are responsible for servicing that account and picking up any old beer out of date.

People do not realize that beer is very perishable. Beer is perishable, and we cannot leave it on the shelves but so long. We have to pick it up. We would be picking up the leavings of an irresponsible transshipper.

INDIANA LAW

The CHAIRMAN. Now, I believe the State of Indiana passed a bill prohibiting what you are asking here.

Mr. PRICE. I believe so.

Mr. PEARCE. I think so.

The CHAIRMAN. The information that we have received on that is that when they did, the price of beer went down. How do you reconcile that?

Mr. PRICE. Mr. Chairman, I do not know overall. I have read probably the same thing you have. I have not been into Indiana to see this. I could understand if he only worked the major chains that this may be possible because that particular transshipper may

be going in with a drayage cost of 25 cents a case. He has no service. He has nothing. He is just delivering the product and putting it down in that particular store.

Now, I would say overall, if that little party shop went out to buy his beer, he may have to get more for that beer than he is getting today because he would have to go haul it back to his place and he would be involved with the transportation instead of, then, the wholesaler being responsible for the transportation.

Mr. CROMARTIE. Mr. Chairman, what happens in a situation where a large superchain can go in and buy 1,000 cases of beer, pay $1 for it on the case, at the same time that same person, that transshipper is not willing to come to my store and drop off 50 cases when he can drop off 1,000 cases at 5 superchains.

That simply means that I have to pay the regular price of $10 a case. He pays $7 a case. He can sell it for $9. It costs me $10. I have to sell it for $11, and I cannot compete because he will not sell to me 50 cases at the same price that he sells 1,000 cases to the superchain.

That simply means that those businesses in the Southeast, in the State of South Carolina that employ most of the people, the small businesses will go out of business, and that is basically unfair.

Now, if he is going to ship 1,000 cases, if these wholesalers drop off 100 cases at my store at $10 a case, if I do not want but 2 cases, they still have to drop it off at $10 a case. If they go to Food Town and deliver 1,000, they get the same price. That is fair. And that is where the problem lies. We cannot survive, and it is the small businesses in the State of South Carolina and in this Nation who employ most of the people. Collectively they are as large as anyone else, and they are the ones who would suffer.

Mr. PRICE. Senator, let us address the consumer a minute. I do not believe we have said very much about that person, and that keeps you, me, and everybody else in business. The consumer today under the present distribution system in which we work has an opportunity to buy more brands of beer than ever before since I have been in this game. Lone Star as an example, just hundreds, not hundreds, but many, many brands have come into our market recently that were never there before.

Also, packaging. These particular brands of beer offer quarts, 12-ounce, 40-ounce, you name it, 16-ounce. It is there. Transshippers only deal in one package. That is all. And I think that is very important to the consumer because the consumer is looking for a variety of sizes.

People are moving around today that never moved around before. The modes of transportation we have. Many of them have desires for a particular brand of beer. That brand of beer today is available in our market that years ago was not there. That is competition as I see it, and strong competition.

BENEFIT TO CONSUMER

The CHAIRMAN. Now, since this law was passed in South Carolina, have you noticed any difference in the price to consumers of beer? In other words, has it been to the benefit of the consumer?

Mr. CROMARTIE. As a retailer, I have found it has been for the benefit of the consumer. Prices are more competitive. Prices have decreased. As a result, I think it is more competitive than ever before.

We found at one time as a retailer that the price went up because of increases in taxes but even though there was an increase in taxes, when this bill passed, it became more competitive, more discounts, and as a result, we still have competitive pricing, very competitive pricing for the beer.

We can sell beer at 99 cents a quart today, and at the same time, it was 99 cents a quart, the identical beer 2 or 3 years ago even though there have been tax increases. And that simply means that we have to make sure that the wholesaler sells it to us cheaper and they have been doing that in order for them to be in a position to get their volume and for the stores to be competitive.

So it is cheaper and it also allows for the small businessman to be able to survive and compete with the giant chains face to face and toe to toe.

The CHAIRMAN. So your statement is that since this law was passed in South Carolina the price of beer has gone down and that the law has benefitted the consumer?

Mr. CROMARTIE. I am saying that the pricing structure has been whereby the pricing from the wholesaler is just as cheap even though taxes have resulted in an increase in the price on the top that is just as competitive and the wholesalers are selling us the beer at such a rate that we can still be in a position to have the same low prices. That is correct.

Mr. PEARCE. That is because, Senator, we have stronger distributors selling more brands of beer in our area than we have ever had before. Now, you know me well enough to know that I do not mind competition.

Fair competition we will meet head-on anywhere anytime. But a transshipper coming in, picking, the cherry-picking as we call it, of the larger accounts is not fair competition. We cannot build a business knowing that this potential may become a reality in the future.

The CHAIRMAN. Now, if what you say is correct, and I do not dispute it, then the law is having the opposite effect in South Carolina from what it had in the State of Indiana, then, is it not?

Mr. PRICE. Mr. Chairman, I think the pricing you got came from the superchains, not an overall pricing. I would believe as has been the case in South Carolina, as an example, and we love the superchains. They do a beautiful job for us, but I can recall years ago when we were in the food business there was a mom and pop on every corner. The mom and pops are not on every corner today. The prices are cheaper in a chain store today in food as we all recognize than they were 15 years ago, compared to that particular item and the cost at that particular time.

But I do believe that the pricing that was given to you is a result of the superchains and not the overall pricing.

The CHAIRMAN. Now, as I understand your testimony, what you three gentlemen are saying is that since the South Carolina law has been passed the consumer has benefited, and also the little business dealers in beer have benefited. Is that correct?

Mr. CROMARTIE. That is correct, sir.

The CHAIRMAN. Is that the essence, Mr. Pearce?

Mr. PEARCE. Very much so other than this point, sir. The small businessman has benefited to the degree that he continues to get the same service, the same pricing, and everything else the big chains get and the larger accounts get. We see, a possibility of transshipping precluding this happening and discontinuing the livelihood of many of these small businesses.

The CHAIRMAN. I want to thank you gentlemen for coming here and testifying. I know you went to a good deal of trouble and we appreciate your presence.

Now, we have another witness here from South Carolina, Mr. Boylston, I believe, from Barnwell, on behalf of the Food Marketing Institute, who takes a different position. You may want to have seats back there and hear him testify. Then we may want to have a little discussion. I may have to leave, but it is possible you will want to answer each other on this question, because it is a little unusual for South Carolinians to come to Washington and take different positions.

Mr. Boylston, if you will come around. Mr. James Reid Boylston III, Reid's Red and White, Barnwell, SC, on behalf of the Food Marketing Institute, and Mr. Matthew Protos, director and past president, National Licensed Beverage Association, Rockville, MD.

Mr. Protos, what position do you take?

Mr. PROTOS. Opposition.

The CHAIRMAN. In other words, you oppose this bill?

Mr. PROTOS. Yes, sir.

STATEMENT OF A PANEL CONSISTING OF JAMES REID BOYLSTON III, REID'S RED AND WHITE, BARNWELL, SC, ON BEHALF OF THE FOOD MARKETING INSTITUTE, AND MATTHEW PROTOS, DIRECTOR AND PAST PRESIDENT, NATIONAL LICENSED BEVERAGE ASSOCIATION, ROCKVILLE, MD

The CHAIRMAN. Now, you heard the testimony given by these South Carolinians. Now, Mr. Boylston, have they convinced you that what they say is correct and that their position should be sustained or do you still take a different position?

Mr. BOYLSTON. I take a different position.

The CHAIRMAN. You take a different position?

Mr. BOYLSTON. Yes, sir.

The CHAIRMAN. Now, do you have a written statement?

Mr. BOYLSTON. Yes, sir; it has been submitted.

The CHAIRMAN. All right. We will put that in the record.

Do you wish to read that or do you wish to speak off the cuff or how do you want to present your statement?

Mr. BOYLSTON. I would like to speak off the cuff, Mr. Chairman.

The CHAIRMAN. All right. Just feel free to do that.

Mr. BOYLSTON. I am from South Carolina, as you mentioned, and I own a single food store. I am here on behalf of myself and FMI. I will just go through some major points and provide some analysis of my views.

S. 1680 is not needed to preserve——

The CHAIRMAN. Let me ask you this. Do you sell beer?

Mr. BOYLSTON. Yes, sir.

The CHAIRMAN. Now, Mr. Pearce sells Budweiser beer. I believe he is the exclusive agent for that. What kind of beer do you sell?

Mr. BOYLSTON. I sell all brands of beer.

The CHAIRMAN. All brands. You sell Budweiser?

Mr. BOYLSTON. I sell Budweiser, Schlitz——

The CHAIRMAN. Where do you get your Budweiser from?

Mr. BOYLSTON. I get my Budweiser from AB Distributing Co.

The CHAIRMAN. Where is that?

Mr. BOYLSTON. That is in Aiken, SC.

The CHAIRMAN. You do not buy through Mr. Pearce?

Mr. BOYLSTON. No, sir; he is in the upper part of the State.

The CHAIRMAN. Mr. Pearce, you do not have the agency for that part of the State?

Mr. PEARCE. No, sir, Mr. Chairman. Unfortunately we do not. I wish we did. He would not be here if we did. [Laughter.]

The CHAIRMAN. You may proceed. You sell all brands, then?

Mr. BOYLSTON. Yes, sir.

The CHAIRMAN. All right. Go ahead.

Mr. BOYLSTON. S. 1680 is not needed to preserve the existing beer wholesale system. The three-tier system protects the wholesaler from competition. Transshipping could never replace the beer wholesaler because the transshipper has to buy the beer from a wholesaler somewhere.

Competition was mentioned many times in the previous testimony. But they were all talking about competition at the retail level, not competition at the wholesale level. My contention is that should transshipping occur in South Carolina, which it cannot because of our State law, my local distributors would have to get more aggressive in their pricing to meet the transshipper's price.

In the food industry, I am faced with major chain competition, even foreign chain competition. And I do not like it, but I have to live with it. There is an alternative, I could get out of the grocery business if I could not stand it.

There are no laws to protect my price margin. I have to sell my products at what the competition will allow me to sell them.

The existing territorial beer wholesale system is not competitive, in my opinion. Budweiser has to compete with Schlitz and Schlitz has to compete with Miller. But in my opinion Budweiser should have to compete with Budweiser. If my Budweiser distributor was not doing a real good job of supplying Budweiser to me, I would like to have the option of buying my Budweiser elsewhere.

The number of large beer distributors in the Nation have significantly increased in the last 9 years. Smaller beer wholesalers are diminishing. Enacting the beer bill will only accelerate this trend.

The CHAIRMAN. Let me ask you one question there. I have got to leave in 1 minute. There will be another Senator here to carry on.

Now, Mr. Cromartie is a small businessman and you heard his testimony. How do you answer his testimony?

COST OF ALL BEERS INCREASED

Mr. BOYLSTON. Well, I would like for him to go back and look at his invoices, because my beer has gone up since the South Carolina law passed.

The CHAIRMAN. The price of your beer has gone up?

Mr. BOYLSTON. All brands have gone up.

The CHAIRMAN. All brands have gone up since South Carolina passed this law?

Mr. BOYLSTON. Yes, sir.

The CHAIRMAN. The consumer now pays more than he did?

Mr. BOYLSTON. Yes, sir.

The CHAIRMAN. Now, that is not consistent with the testimony of the people who spoke here.

Mr. BOYLSTON. Well, I think the record will speak for itself. I mean, it would be a simple matter to go look at some invoices and determine exactly whether prices have gone up or not. I didn't bring any invoices with me. I should have.

But my beer has shown increases, and since this law has passed, my beer wholesalers have discontinued a lot of practices that involve dealing in volume amounts of beer. For example, if I bought 100 cases, I would get so much a case off. Or I would get one free if I bought 25 cases. They are now discontinuing this and in effect, the price is going up and it is costing the consumer more.

It was mentioned that the consumer has——

The CHAIRMAN. If you will wait, I have to leave on another appointment. Senator DeConcini will be here and carry on this. Now, after you gentlemen who are against this bill testify, if Mr. Pearce, if you all want to come back and have a little rebuttal you can do that. Then if they want to answer you, we will give them a chance. We want to give a full airing here of this thing, because somebody is evidently in error about the prices and effects this is having, and we want to try to get to the bottom of this thing.

We may have to get some information from the Tax Commission in South Carolina or the ABC.

Mr. BOYLSTON. I think if you ask them a simple question, has the price of beer increased in South Carolina since January, they would say, yes, it has increased.

The CHAIRMAN. I see. We will take a 5-minute recess now.

[Whereupon, a short recess was taken.]

Senator DECONCINI. You may continue with your testimony.

Mr. BOYLSTON. I have a friend that has a soft drink distributorship near me, and the reason I am bringing soft drinks into this is because they have laws similar to what S. 1680 would be.

He is not an aggressive Coca-Cola distributor. He has not bought new equipment over the years. He has been content to deal with his customers the same way he has dealt with them for the last 50 years, and he has been offered $4.5 million for his bottling company. I just do not want to mention any names.

To me, what he would be selling is not his physical facility or his plant, but he would be selling his territory forever and ever and ever and ever.

I do not think S. 1680 will merely codify and clarify existing laws. I think it would change the law. Exclusive territories that are

procompetitive are OK. But if S. 1680 passes anticompetitive exclusive territories will also be legal.

I would like to relate to the wholesale grocery business. I buy from several different wholesale grocery companies. I buy from two companies that distribute the same private label brand, and both companies have exclusive territories for those brands. But no law says they have exclusive territories.

But those wholesalers are now selling merchandise in each others trade areas because the grocery business at retail has become so competitive. It is much easier to steal a customer than it is to start a new store from scratch. The position it puts me in is I am able to buy my private label product from more than one source. And I am able to buy, say, my fruit products from one supplier and my vegetable products from another supplier with the same label and thereby get the best price to pass on to my customers.

I do not think that S. 1680 strengthens States' rights. The trend has been to give the States more rights, and I think S. 1680 will act to the contrary.

The beer bill passed last year in South Carolina. The beer lobby in South Carolina is a close-knit organized group, and when the retail merchants in South Carolina got wind that the hearing was taking place, the outcome was already cut and dry. I mean, independent grocers are busy running their stores, stretched out all over the State, and we have very little time to talk with each other, and our lobbying effort is not nearly as precise and effective as the beer lobby.

I do not think that S. 1680 will improve service to small retailers. Small retailers right now only have one place to buy a particular brand of beer. We were talking about Budweiser earlier. A retailer of Budweiser beer in a certain area of South Carolina has no choice but to buy that Budweiser only from one particular distributor.

If that particular distributor chose not to give him real good service, he would have no alternative but to take it or leave it. Here again, I would like to mention a situation with Coca-Cola which has the same rules.

I have a good friend that has a store, the same store or same chain of stores that I do, Red and White, 14 miles away from me. He is supplied by one Coca-Cola distributor. I am supplied by another Coca-Cola distributor.

We have the same newspaper. He advertises his 2-liter Cokes at 99 cents, and he has a margin of 15 to 18 percent. I advertise my 2-liter Cokes at $1.29 and I am only making 7 to 8 percent.

My store is about twice the size of his. I do about twice the volume he does, but I look like my Coca-Cola price is high, and there is nothing I can do about it. There is nothing I can do about it because legally I cannot go buy from his Coca-Cola distributor. His distributor just happens to be more aggressive than my distributor, and I and my customers suffer from it.

The argument that beer is perishable is untrue. It lasts 60 to 120 days. We have chickens and lettuce and bread and many other far more perishable products. It is up to us to regulate the freshness of our products, not the State or the Federal Government.

If I sell bad products, my customers are going to quit buying them, and I am going to suffer. So I do not think the freshness argument is legitimate at all. If it is so important, I do not know why we do not have open dating on beer.

I believe that S. 1680 will definitely lead to higher prices. The price competitiveness at the retail level is a real factor, but we need price competition at the wholesale level too.

If a transshipper was legally able to come into my trade area and sell Coca-Cola or beer, and they sold the major chains thousand-case lots of beer at $2 a case less than what I was paying for it, I feel sure that my local distributor would lower his prices.

I am operating on about a 16.5-percent gross margin in groceries right now. Groceries account for 60 percent of my sales. My expenses run me, my total expenses run me in excess of 19 percent.

So I am selling 60 percent of my goods at 2.5 to 3 points below my expense factor. Why should I have to deal with this kind of competition when a brewery is guaranteeing an exclusive territory?

I mean, I wish I had an island with just me and an IGA and a Pigly-Wiggly, and the island was growing and nobody could ever build another store on it, forever. That would be a nice situation to be in, and that is what, in effect, exclusive territories do.

I do not think S. 1680 has grassroots support. The brewers, wholesalers, and the teamsters support the beer bill, but many State and local associations oppose it strongly. I could name 50 groups or more. S. 1680 is anticompetitive and it would make the consumer pay more.

There is a $3 or $4 a case difference between 1,000 cases and 50 cases. That would lead you to believe there is a whole lot of markup in beer at the wholesale level. I am not used to dealing with anything with that kind of markup.

If the superchains are able to get this merchandise, I am sure that if I have the money that I will be able to get the merchandise at a competitive price.

By the way, every wholesaler that I buy from, I either pay on monthly or bimonthly terms, or either I get cash discounts. But with my beer wholesalers, I have to pay cash on delivery, or check on delivery.

The beer industry could be a lot more competitive, in my opinion. Thank you, sir. If you have any questions, I will be happy to try to answer them.

Senator DECONCINI. I have one question, Mr. Boylston. You are familiar, of course, with the Soft Drink Interbrand Competition Act that was passed here?

Mr. BOYLSTON. Yes, sir.

Senator DECONCINI. Has that been detrimental to you?

Mr. BOYLSTON. As I was saying, yes, sir. It puts me at a definite disadvantage, especially because I am near the line that separates two distributorships.

Senator DECONCINI. What about the quality of your goods? Does that create a problem?

Mr. BOYLSTON. I have no problem with the quality of my beer products or my soft drink products. That has never been a problem.

I mean, I have gotten good service. I cannot complain about that. But they can afford to give me good service.

Senator DECONCINI. One of the things that troubles me, I suspect you may have this problem in South Carolina, is that in some very warm States beer and soft drinks but especially beer, if transported into another's franchise, as is often the case when large retailers buy it off carloads, and then move it to their chain store in another area, that complaints of poor quality ensue.

Sometimes those people are smart enough to absorb the loss themselves. Sometimes they tell the customer tough.

Mr. BOYLSTON. Well, all of my lettuce comes from California, and it is a lot more perishable than beer, and I manage to keep fresh lettuce and I manage to keep a competitive price on it.

Senator DECONCINI. But you are not reshipping it. That is the problem I am talking about.

Mr. BOYLSTON. I am buying it from people that are reshipping it.

Senator DECONCINI. You are buying it from a wholesaler, are you not?

Mr. BOYLSTON. Yes, sir. But if lettuce and fryers are no problem, well, the fryers are local, but just lettuce is a good example, I mean, it all comes from California or 90 percent of it, and perishability is not a problem. We deal with that everyday, and it is not the Government's responsibility to regulate that.

Senator DECONCINI. My point is when you deal with a wholesaler that is your supplier, but if you have become a wholesaler by dealing with your other chain stores, that troubles me.

Mr. BOYLSTON. I do not understand. If I become a wholesaler, you say. I do not understand.

Senator DECONCINI. Yes; if you take that lettuce and you put it in your store, another 500 miles away, like the beer merchant does or the retailer in the large store that has 50 stores and they buy the beer from Budweiser, and then they truck it down 300 miles away into somebody else's franchise, they really become a wholesaler, which is not their area of commerce. They are to be retailers.

It troubles me that the big guys are going to have the advantage. So the big guy may come in, buy lettuce, and sell it for less than right next to you.

Mr. BOYLSTON. But who would ultimately benefit from this?

Senator DECONCINI. It depends on the quality of the lettuce and the service that one gets.

Mr. BOYLSTON. Well, if my major competitor starts selling lettuce cheaper than I do, then whoever I buy my lettuce from is either going to have to get out of the lettuce business or learn how to compete, and I just do not think anybody ought to be immune from competition in even intrabrand competition.

I compete. I wish it was not the way it is but it is, and I think everybody ought to eat out of the same trough that I do.

Senator DECONCINI. My reaction to the Soft Drink Interbrand Competition Act is that it has been a positive influence on the market. You tell me otherwise.

Mr BOYLSTON. I am saying in my particular instance, it has made my price look high simply because my distributor does not have to be competitive. We had a beach festival in my home down this past weekend, and I was out of Coca-Cola.

Senator DECONCINI. Do you have to sell Coca-Cola? You could not go to Pepsi Cola?

Mr. BOYLSTON. No, I had Pepsi. In fact, I put Pepsi Cola on a Coca-Cola shelf, but I had no alternative. I could not go and get Coca-Cola from another distributor. My local Coke distribute has just been bought by a big Coke distributor. I am telling you. It is unbelievable what is happening.

Senator DECONCINI. Why do you not just buy more Pepsi if that is better?

Mr. BOYLSTON. That is my only choice, sir. But some of my customers demand Coke, as they do a certain type of beer. I have to stock what my customers want, or I will lose them.

Senator DECONCINI. No, of course you could not. You let them buy and pay the high price. But if you sell another brand and you really believe in competition, you would buy more Pepsi or whatever costs less.

Mr. BOYLSTON. We already have enough Federal intervention in our retail structure. I think we can manage quite well on our own.

Senator DECONCINI. So you are saying that the Soft Drink Act has really not helped?

Mr. BOYLSTON. No, sir. It has helped the distributors.

Senator DECONCINI. Thank you.

[The following was received for the record:]

STATEMENT OF

JAMES REID BOYLSTON,III

REID'S RED AND WHITE

BARNWELL, SOUTH CAROLINA

for the

FOOD MARKETING INSTITUTE

Mr. Chairman, on behalf of the Food Marketing Institute (FMI) and its 1300 member food retailers and wholesalers, I am grateful for the opportunity to testify in opposition to S. 1680, the so-called Malt Beverage Interbrand Competition Act.

FMI is a non-profit trade association whose membership consists of independent grocers, food chains, and voluntary and cooperative wholesalers. Our domestic member companies operate over 17,000 retail food stores with a combined annual sales volume of $130 billion -- half of all grocery sales in the United States. More than three-fourths of FMI's membership is comprised of independent supermarket operators or small regional firms, and more than half of our retailer members are single store operators.

FMI is strongly opposed to S. 1680 for the same reasons cited during the deliberation of identical legislation in the 97th Congress -- it is anticompetitive, anticonsumer and inflationary.

The purpose of S. 1680 and its companion bill in the House, H.R. 2262, is to grant the beer industry a special exemption from existing antitrust laws. Specifically, S. 1680 would immunize beer wholesalers' exclusive territorial arrangements from antitrust challenge, thereby allowing brewers and their franchised wholesalers to enter into agreements creating exclusive distribution territories without fear of violating existing antitrust laws.

In our view, particularly after examination of the characteristics of the beer wholesale industry, it is clear that the justifications cited for the need to enact S. 1680 have no substantive merit, that passage of S.1680 would create a dangerous precedent, and that the spirit of S. 1680 runs contrary to the positive trend toward the deregulation of American business.

S. 1680 NOT NEEDED TO PRESERVE EXISTING BEER WHOLESALE SYSTEM

One of the principal arguments offered by the proponents of this bill is that it is needed to preserve the existing beer wholesale distribution system. This contention is simply not true. There is no threat to the present beer distribution system. It is the beer industry itself, through this legislation, that is seeking to alter the status quo.

Under the three tier system of distribution adopted in every state in the country, beer wholesalers are already provided with a privileged status and are protected from new and perhaps more competitive approaches to distribution. State malt beverage laws or regulations require the maintenance of three completely independent phases of distribution. This requirement means that vertical integration between the brewer, the beer wholesaler and the beer retailer is prohibited. Thus, the brewer is prohibited from selling directly to the retailer. Laws and regulations in every state in the country require that the brewer must sell to the independent wholesaler, who in turn sells to a non-affiliated retailer. Similarly, the retailer, no matter how large or small, cannot bypass the beer wholesaler by purchasing directly from the brewer. Therefore, retailers must purchase their beer from the authorized beer wholesalers.

Given this fact, it is hard to understand why representatives of the beer wholesale industry claim that without guaranteed rights to exclusive territories, the grocery "megachains" will take over beer wholesalers. This cannot happen because the effect of the three-tier distribution system is to secure beer wholesalers an unchallengeable place in the chain of distribution, leaving them free of the competitive pressures faced daily by other wholesalers. Therefore, one cannot convincingly argue that exclusive territories are necessary to protect beer wholesalers, since state-mandated three-tier distribution systems effectively provide such protection. To be

sure, no other industry in the wholesale sector, including soft drink and grocery wholesalers, enjoys such protection from the competitive threats of vertical integration.

Further, the protection enjoyed by the beer wholesale industry does not end with the protection provided by the nation wide requirement of the three-tier distribution system. Strict state licensing requirements at all levels of beer distribution create significant barriers to entry in the beer wholesale industry. While licensing requirements vary from state to state, the requirements in most states inhibit the entry of new competitors, thereby further limiting competition among beer wholesalers.

In short, given the privileged and protected conditions under which beer wholesalers already operate, there is simply no rational reason why beer wholesalers can claim that they need the additional protection that guaranteed exclusive territories provide. By unconditionally guaranteeing the right of brewers and their distributors to enter into exclusive territorial arrangements (which is what S. 1680 is intended to do), one is simply expanding the already privileged status of beer wholesalers by legally insulating them from the potential competition of other beer wholesalers. In sum, the proponents argument that this bill is necessary to protect beer wholesalers from retailers is totally ingenuous. The beer bill only protects wholesalers from wholesalers.

EXISTING AND TRADITIONAL BEER WHOLESALE SYSTEM IS NOT COMPETITIVE

At the same time, while arguing that S. 1680 is necessary to protect beer wholesalers, proponents of the bill also claim that it will help maintain the high degree of competition that exists in a beer wholesale industry supposedly dominated by small businesses. In fact, all available evidence suggests that the passage of S. 1680 will ensure that we are locked into what is quickly becoming a highly uncompetitive beer distribution system, where the proportion of smaller wholesalers is rapidly diminishing. In its testimony against the beer bill the Justice Department pointed out that while concentration in an industry can in many instances actually improve competition, the beer industry is unique in that it is characterized

by strong barriers to entry, in addition to growing concentration at both the brewer and wholesale level.

According to an article published in the January 28, 1983 edition of Beverage Industry, the total number of alcohol beverage wholesalers has been on a steady decline, falling at an average rate of about 1% per year. However, the bulk of the decline in the number of alcohol beverage wholesalers is due principally to the declining number of beer wholesalers. In 1958, for example, there were over 6,000 beer wholesalers. By 1982, the number of beer wholesalers had fallen to slightly over 4,500 while, in that same time period, the number of wine and spirits wholesalers had increased from 1,662 to 1,972. In other words, the drop in the number of beer wholesalers has been great enough to outweigh the growing number of wine and spirits wholesalers, and give a negative growth path to the alcohol beverage wholesale industry as a whole.

The major factor fostering the decline in the number of beer wholesalers has been the accelerating concentration at the brewery level. Since 1965, the combined market share among the top three brewing companies has increased from 24% to 68%. This development, in turn, has contributed to growing concentration in the beer wholesale industry. Many of the beer wholesalers that distributed the non-leading brands have been forced out of business in the face of declining sales and rising operating costs. Between 1980 and 1981 alone, the number of beer wholesalers with sales over $25 million increased by 36%, while the number of companies with sales under $25 million actually declined by almost 2%. It is estimated that by 1990, the proportion of beer wholesalers with sales over $25 million will rise to almost 10%, compared to 1.0% in 1981, and that the number of beer wholesalers with sales under $2 million will have declined by almost 90%.
As a result, sales concentration will be sharply higher by 1990, with almost 40% of total sales being accounted for by firms with over $25 million in sales. By comparison, the latter group controlled 10.7% of total sales in 1981.

Obviously, the competitive state of an industry cannot be judged from concentration data alone. Market entry must also be assessed. High levels of concentration need be of little concern if market entry is occurring on a

regular basis or if the actual barriers to potential entrants are low. This mitigating economic force is not present in the beer industry. Beer wholesaling combines high and growing concentration with very high entry barriers.

It is precisely this combination of growing concentration at the brewer and wholesale levels, in conjunction with the existing strong barriers to entry that has led the Federal Trade Commission to state that,

> ...the combination of high concentration and state-created entry barriers do make this an industry in which it is particularly important to safeguard against anticompetitive conduct such as collusion among brewers of wholesalers.

Similarly, the Justice Department stated in a letter to this Committee:

> ...this industry appears to be one in which the risk that widespread use of exclusive territories may produce anticompetitive effects is almost uniquely high.

Stated differently, the Justice Department and the Federal Trade Commission recognize that the environment in the beer wholesale industry is not highly competitive as argued by the proponents of this bill, and that rather than preserving a high degree of competitiveness, S. 1680 would accelerate what is already becoming one of the most uncompetitive industries in this country.

Does the beer bill really help the small beer wholesalers? If S. 1680 were enacted, what is already becoming a bad situation for small beer wholesalers will rapidly become a hopeless situation as they are legally prevented from growing into expanding natural market areas.

S. 1680 WILL NOT MERELY CODIFY AND CLARIFY EXISTING LAW

Contrary to what the proponents of this bill say, the passage of S. 1680 would result in a drastic change in existing antitrust law, and would result in greater rather than less confusion regarding the interpretation of antitrust law.

The existing rule of reason approach used in determining the legality of vertical restraints makes it clear that antitrust laws permit the use of exclusive territorial arrangements, except in those situations where they may

have anticompetitive effects. As stated by the Justice Department in testimony before this Committee last November,

> The Justice Department recognizes that exclusive territorial arrangements have beneficial effects in a wide range of market settings. Therefore, we view such arrangements as legitimate in most cases; they should be prohibited only where their effect may be substantially to weaken the interbrand competition.

The effect of S. 1680, however, would be to permit the use of exclusive territorial arrangements in the beer industry, regardless of whether or not individual territorial arrangements may produce anticompetitive effects. Such an approach to judging the economic merits of exclusive territorial arrangements is hardly a "codification" of existing law, but rather a significant change.

The language in S. 1680 states that exclusive territories shall not be deemed to be illegal so long as the given wholesaler is involved in "substantial and effective competition with other malt beverage products within the defined geographic area."

This language implies that the mere existence of interbrand competition is sufficient to ensure that exclusive territorial arrangements will not have anticompetitive effects. However, this is not consistent with the rule of reason approach. While interbrand competition is a primary concern of the antitrust laws, its mere existence does not justify the elimination of intrabrand competition as S. 1680 would do. Rather, the rule of reason requires a balancing test. Is the lessening of intrabrand competition by the restraint outweighed by a positive impact on interbrand competition?

On the other hand, S. 1680 would justify the total elimination of intrabrand competition on the grounds that some undefined degree of interbrand competition exists and is all that is needed. Thus, rather than confirming and codifying the balanced and flexible rule of reason approach adopted in the Supreme Court's deliberation of Continental TV, Inc. v. GTE Sylvania, S. 1680 would clearly alter present law by focusing exclusively on the mere existence of interbrand competition. In essence, this precludes any attempt to balance any given procompetitive and anticompetitive effects of territorial restraints, and eliminates the ability of the courts to take into account the

potentially anticompetitive effects vertical restraints can have at the horizontal level.

While the treatment of exclusive territorial agreements is eminently clear under existing law, S. 1680 would not succeed in clarifying existing law even if it did need clarifying. The Federal Trade Commission testified before this Committee that the "substantial and effective competition" language in the bill is so vague that it is likely to foster more litigation. In any case, there is no evidence to support the contention that the current rule of reason approach is in fact creating confusion fostering costly litigation. The lower courts have shown no reluctance to apply the Sylvania ruling to vertical restraints, including territorial restraints in a variety of industries. Moreover, the circumstances in the beer industry are not analogous with those that existed in the soft drink industry, where confusion regarding the applicability of antitrust laws was created following an FTC ruling that market conditions in the industry made vertical restraints per se illegal in the soft drink industry.

Further, even if a case could be made that confusion did in fact exist regarding the interpretation and applicability of the existing antitrust laws to exclusive territorial arrangements, the Supreme Court's Sylvania decision stated that legal certainty is not and should not be the paramount concern in the area of trade regulation. The Supreme Court noted that while per se rules do provide certainty to the business community and can reduce litigation burdens, those advantages "are not sufficient in themselves to justify the creation of per se rules."

Therefore, one can reasonably argue that S. 1680 clearly runs contrary to the Supreme Court's line of reasoning in Sylvania, as it would effectively create a per se rule immunizing a single industry from antitrust laws on the grounds that it fosters greater legal certainty.

In short, there is no basis to the contention that existing antitrust laws need clarifying. If there was such a need, the language in S. 1680 would not do so, and even if it did, the manner in which it clarified existing law (i.e., by creating a per se rule immunizing a single industry) would be inconsistent with the Supreme Court's treatment of trade regulation.

S. 1680 DOES NOT STRENGHTEN STATES RIGHTS

Contrary to what the proponents of S. 1680 say, this bill does not confirm the states' right to regulate the sale and distribution of beer. The purpose of S. 1680 is clear and simple -- to promote exclusive territories in states that do not yet have laws or regulations requiring exclusive territories. Since enactment of S. 1680 will provide antitrust immunity to those arrangements, exclusive territories will become the rule, unless a state specifically prohibits them. Consequently, S. 1680 would result in federal intrusion into what is traditionally a state matter, since the effect of S. 1680 is that the federal government would be endorsing a specific beer distribution system. In the event that a state chooses to take no position on territorial arrangements, a common situation, federal law would take effect in those states by sanctioning the right of wholesalers to enter into exclusive agreements with brewers. Thus, in those circumstances, federal law would dictate what is presently within the authority of the states to decide.

In addition, the argument that S. 1680 is needed to confirm the states' right to regulate the sale and distribution of beer because the application of existing antitrust laws violate the twenty-first amendment is completely specious. Under the "state action immunity" doctrine in Parker v. Brown, a regulatory scheme is protected from antitrust laws if the state has a clearly articulated or affirmatively expressed policy requiring restrictive arrangements which is actively supervised. However, whenever states rights embodied in the twenty-first amendment clash with antitrust laws, it is well established that antitrust laws can take precedence. In arriving at its decision that a California law imposing a retail price maintenance scheme violated antitrust laws (California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.), the Supreme Court noted that "...the Twenty-First Amendment provides no shelter from a violation of the Sherman Act." Indeed, it would appear that because proponents of this bill are fully aware that federal antitrust laws can at times supersede the rights of states under the twenty-first amendment, they seek an antitrust exemption for their industry.

In any event, it is well established that the application of antitrust laws to the distribution of alcoholic beverages is not a violation of states rights under the twenty-first amendment. However, one can persuasively argue

that the effort to obtain a federal endorsement of a specific beer distribution scheme at the state level does intrude on the states rights to regulate alcoholic beverages.

S. 1680 WILL NOT IMPROVE SERVICE TO SMALL RETAILERS

The proponents of S. 1680 also contend that without exclusive territorial arrangements, small retailers will get inadequate service. According to their line of reasoning, without the protection and certainty offered by exclusive arrangements, wholesalers who move in on their territories and take a "free ride" on the investments made by franchised distributors in helping retailers market their products.

This is by far one of the weakest arguments offered by proponents of this legislation. In the first place, if beer wholesalers are allowed to operate under exclusive territorial arrangements without fear of violating antitrust laws, and do not have to compete with other wholesalers for the business of a given market of retailers, common sense, conventional economic doctrine and real world practices dictate that the chances are greater that service to retailers will deteriorate. Small retailers, in particular, are likely to suffer the most since wholesalers with captive markets are likely to focus more of their efforts on serving the larger accounts. On the other hand, if there is greater freedom of entry in the beer wholesale business, the small retailer will benefit from better service as competing wholesalers attempt to increase their respective market shares.

For example, in Indiana where exclusive territorial arrangements are prohibited, small retailers benefit from a highly competitive beer wholesale market by combining their orders and buying as cooperatives. As a result, they receive the same price advantage that large volume retailers are capable of obtaining. However, if exclusive territorial arrangements were permitted in Indiana, many small retailers in that state would be precluded from taking advantage of buying cooperatives, as they would be forced to purchase from a single wholesaler who would not necessarily be as interested selling at competitive rates since there would be no incentive to do so.

In short, to contend that the preservation and perpetuation of captive markets will somehow protect small retailers defies common sense. The best way to guarantee competitive service to small retailers is to permit the marketplace to work by allowing wholesalers to compete freely, unencumbered by rigid and artificial marketing restrictions.

In addition, there is no evidence that independent wholesalers who sell across established captive market areas of franchised distributors are getting a "free ride". In addition to selling beer at lower prices, all available evidence suggests that these independent wholesalers provide small retailers with a wider variety of brands and perform the same quality control functions. The very existence of these so-called transshippers indicates that they are fulfilling a demand that is not being adequately met by the more conventional franchised distributors. Further, if franchised wholesalers with captive markets are doing as good a job in serving the smaller retailers, it is hard to understand why they view independent wholesalers as such a competitive threat.

Finally, if captive markets are as beneficial to retailers as proponents of this legislation claim, then it is equally difficult to understand why there are no groups representing retailers that support passage of S. 1680. In fact, the major trade associations representing small grocers, convenience stores, bar and tavern owners are staunchly opposed to S. 1680.

S. 1680 NOT NEEDED TO ENSURE THAT ONLY FRESH BEER IS SOLD

There is absolutely no substance to the contention that beer spoilage is a major problem. It is commonly accepted that the average shelf life of beer is anywhere from 60 to 120 days. Professor of Economics W. John Jordan of Seton Hall University, has estimated from New Jersey tax returns that approximately 90 out of every one million cans of beer go bad. However, even if one assumed for a moment that beer spoilage was indeed a significant problem, then it could be dealt with easily by dating the product as is currently done with much more perishable food products.

At the same time, there is no reason to believe that exclusive territories promote the sale of fresh beer more than open competition among wholesalers does. In a hearing before the Indiana Alcoholic Beverage Commission in 1982, several retailers testified that during the days when exclusive territories were permitted in Indiana, wholesalers typically failed to check code dates. One small retailer testified that under exclusive territories there seemed to be little concern for quality. The same retailer stated that she often received deliveries from her wholesaler in a flat bed truck, regardless of whether the temperature was below zero in January or 100 degrees in August. The retailer stated she was never educated by her wholesaler, and that her wholesaler did not check the dates of her products, and was never offered a promotional price or idea.

In contrast, the same retailer testified that her current independent wholesaler never left a load of beer without going into her store and checking the dates and temperatures. She stated that they also educated her in how to handle and present the beer, and told her of the various promotions which the breweries were conducting. Several additional retailers at the hearing gave similar accounts, making it clear that the natural incentives of competition had provided them with better service at a better price.

More importantly, however, there is no logical connection between the supposed beer spoilage problem and the need for antitrust immunity. If there was such a connection, then all food producers and wholesalers who deal daily with products that have a much greater potential for spoilage, could also argue that they should be exempt from the scrutiny of antitrust laws. Obviously, this is a ludicrous proposition, but it is one that flows logically from the beer spoilage argument.

As a practical matter, it is ultimately just as much in the best interest of the retailer as it is of the wholesaler, to ensure that the beer they carry is fresh and that the beer stock is rotated at regular intervals. In the event that a given wholesaler and retailer are not diligent in maintaining adequate quality control, then the disciplining factor should be an eventual loss of business, not government protection.

S. 1680 WILL LEAD TO HIGHER PRICES

In 1981, The Indiana Alcoholic Beverage Commission Study Committee reported that the wholesale and retail price of beer declined by approximately 20 percent in the mid 1970's as a result of the onset of wholesaler competition. Similarly, according to a price survey conducted by the Indianapolis Star, the price of beer in Terre Haute, where there is little wholesale competition, averaged almost 20 percent higher than beer prices in Indianapolis, where wholesale competition is significant. Further, in testimony before the House Judiciary Subcommittee on Monopolies and Commercial Law, New York State Attorney General Robert Abrams stated that the price of Miller and Anheuser Busch beers in New York City rose by 30% in the first ten months after Anheuser Busch and Miller entered into exclusive territory agreements with their New York wholesalers.

This is a particularly predictable effect in the beer industry where brand loyalty created by millions of dollars in advertising is very strong. Consequently, since this bill would eliminate intrabrand competition, there would be a strong incentive for a single wholesaler who controls a particular brand to charge the highest possible price that the market will bear.

Further, at the Indiana Alcoholic Beverage Commission hearing in 1982, several retailers gave testimony supporting the view that in addition to poor service, under exclusive territory arrangements little interbrand competition existed, and the risks of collusion appeared to be much greater. Indiana retailers who had been in existence during the days when exclusive territories were permitted in that state, testified that in those days they were receiving virtually identical prices for comparable brands. Moreover, those retailers stated that whenever price increases occurred, they occurred contemporaneously across the board.

In addition, a study of the New Jersey beer wholesale market conducted by Professor Jordan showed that due to a lack of intrabrand rivalry, retailers in some regions were paying 12 percent more for the same beer brand than that paid by retailers located in another region.

Clearly, these examples are indicative of what one would expect to happen when competition is severely restricted in any market and buyers are forced to purchase from the only available supplier -- prices are higher than what would otherwise be the case in a more competitive environment.

Overall, there is enough evidence available to make it self-evident that a major effect of the granting of monopoly powers to beer wholesalers will be a rise in the price of beer at both the wholesale and retail levels. It is up to the proponents of this legislation to prove that beer prices would not increase as a result of S. 1680. Their testimony to date has been shown to be lacking in substance and credibility. We challenge them to prove their point, and we feel that members of this Committee should do the same.

S. 1680 DOES NOT HAVE BROAD GRASSROOTS SUPPORT

Contrary to what supporters of this bill would have one believe, S. 1680 does not have broad-based support. In fact, only the brewers, beer wholesalers, the Teamsters union and state liquor administrators favor passage of S. 1680. Conversely, the list of opponents to S. 1680 ranges from independent grocery store owners, small business operators, convenience stores and tavern owners to consumer groups and state attorneys general. The list is extensive and appears at the end of my testimony.

Similarly, as indicated by the dramatic drop in cosponsorship since the 97th Congress, support in the 98th Congress for S. 1680 and H.R. 2262 has eroded substantially. At this juncture in the 97th Congress the beer bill had 59 Senate cosponsors - today there are 38. In the House there were 264 cosponsors - today there are 149. It is clear that many members have wisely recognized the ill-conceived nature of this bill.

Finally, as one would also expect, editorial comments on S. 1680 and its predecessor in the 97th Congress have been universally negative.

CONCLUSION

Mr. Chairman, we sincerely hope that you and the members of this committee will strongly oppose enactment of this bill, and that you will see to it that any similar legislation is never given favorable treatment.

Passage of the so-called Malt Beverage Interbrand Competition Act can only lead to a less competitive beer industry and to higher beer prices. Proponents of this bill have not been able to make a convincing case that competition in the beer wholesale industry is unworkable and that because of unique economic circumstances the beer industry merits special treatment and protection. The existing rule of reason approach to deliberating the merits of vertical restraints is clear, balanced, flexible, and fair. Granting the beer wholesale industry an antitrust exemption would only broaden their already privileged status under state laws, and would give them license to violate the sensible laws that preserve the dynamism of our free enterprise system, and that all other businesses must abide by.

Passage of S. 1680 would set a very dangerous precedent as other industries would seek similar protection. At a time when American business is struggling to regain its competitive position in the world economy, such legislation is clearly counter-productive because it protects and promotes inefficiency. Moreover, we have made great strides in recent years in promoting the deregulation of many major American industries. The intent and spirit of S. 1680 goes against the principles embodied in that trend.

The so-called Malt Beverage Interbrand Competition Act is blatantly self-serving legislation, and can only benefit the beer industry to the detriment of our antitrust laws, American consumers and retail businesses. Thank You.

WHO OPPOSES THE BEER BILL?

NATIONAL ASSOCIATIONS:

Consumer Federation of America
Congress Watch
Consumers Union
National Consumers League
Community Nutrition Institute
National Association of Attorneys General
National Institute of Economics and Law
Federal Trade Commission
Department of Justice
Independent Beverage Distributors Alliance
National Small Business Association
American Retail Federation
National Licensed Beverage Association
Food Marketing Institute
National Grocers Association
National-American Wholesale Grocers Assoc.
National Assoc. of Chain Drug Stores
National Assoc. of Convenience Stores
Indiana Malt Beverage Association

STATE/LOCAL RETAIL/GROCER ASSOCIATIONS:

Indiana Retail Grocers Association
Michigan Merchants Council & Associates
Wisconsin Association of Food Dealers
Tennessee Retail Grocers Association
Missouri Retailers Association
Texas Retailers Association
Pennsylvania Food Merchants Association
New York State Food Merchants Association
Indiana Retail Council
Nevada Retail Association
Wyoming Retail Merchants Association
Cleveland Food Dealers Association
California Grocers Association
Michigan Food Dealers Association
Rocky Mountain Food Dealers Assn.
South Dakota Retailers Association
Southern California Grocers Association
Connecticut Food Stores Association
Washington State Food Dealers Association
Pennsylvania Grocers Association
New Mexico Food Dealers Association
Idaho Retailers Association
Oregon Food Industries
Louisiana Retail Food Dealers Assn.
Ohio Council of Retail Merchants
Rhode Island Food Dealers Association

Food Industry Association Executives

Senator DECONCINI. Our next witness?

Mr. PROTOS. Senator, before I get into my testimony, I would like to state that in the exemption of antitrust laws in the soft drink industry, to the best of my knowledge, the price of soft drinks have increased dramatically since they have gotten the exemption from the antitrust laws, and second, I would like to raise the question to the beer wholesalers, will this bill actually stop transshipping, because I also know that transshipping in the soft drink industry is as flourishiing as much as it ever has. So it is really not a deterrent to transshipping.

Mr. Chairman, my name is Matthew Protos, and I am here today speaking as a retailer, representing the National Licensed Beverage Association in opposition to S. 1680.

Senator DECONCINI. We will put your full statements in.

Mr. PROTOS. I appreciate the opportunity to present our views at this time. The National Licensed Beverage Association is a nonprofit trade association offering services in public affairs, education and research to our more than 30,000 members who operate licensed beverage retail establishments nationally.

The majority of these small business people have a deep concern about the consequences of S. 1680 if it should become law. They are very worried about the detrimental effects it will have on their businesses, their livelihood and their families.

Their major concern is that neither the small businessman nor the consuming American public would be served best by granting special exemption to the antitrust laws of our Nation to a self-interest group.

This action would create beer barons throughout the marketplace and create a monopolistic situation for which the American consuming public will pay the price.

The first granting of self-interest groups special exemption to antitrust laws will surely open a pandora's box and encourage every other self-interest group to seek similar treatment.

After all, the legal monopoly could be very lucrative. Already other organizations are waiting in the wings to see what action is taken on S. 1680. There is no doubt in my mind that if the beer wholesalers receive favorable action on this legislation, the wholesalers of distilled spirits and wine will submit legislation of their own granting them the same privilege.

In reality this has already happened. Just a few years ago Congress set a precedent by allowing the soft drink industry exemption to antitrust. Today we have proof that others will seek this exemption. That is why we are here.

Let us not forget the antitrust laws were enacted for the protection of the small businessman and the consuming public. In this case, special exemption to the laws can only take away that protection and lay open the small businessman and consuming public to the whims of the beer wholesalers who would have exclusive rights to sell their brands of beer to retailers within the boundaries of their kingdoms.

As in any feudal economy, this one, too, would be supported on the backs of the peasants, in this case the consumer.

Furthermore, in ever increasing numbers beer wholesalers are becoming multiple brand distributors. This means that a whole

saler can carry beer from five or six different breweries, often two of the top selling brands in the country.

Under exclusive territory laws, a wholesaler may carry this variety of brands on his truck but he does not have that same exclusive territory for all these brands. This situation places the retailer in an unfair competitive position because he would possibly pay a higher price to a wholesaler with a territorial right for a particular brand because he cannot purchase that brand from another wholesaler servicing him. Since breweries usually assign territories along county lines or major highways, a retailer on one side of the road may pay more for a brand of beer than his competitor across the same highway is paying for the same brand.

When legislation dictates purchasing restrictions on any retailer, it limits his ability to function under normal business conditions to purchase at a favorable price. The lack of ability to follow traditional purchasing guidelines results in higher prices and higher operational costs for the retailer and ultimately higher prices for the consuming public.

The principal arguments for the proponents of S. 1680 are the need to eliminate transshipping which could result in stale beer and that beer wholesalers would not have to spend large sums of money in legal fees and years of litigation to defend their innocence under the antitrust laws.

I have addressed both of these arguments in my written testimony. I just make the point here that none of the arguments favoring the passage of this proposed legislation justifies granting a special exemption to the Federal antitrust laws to a self-interest group.

There are purely legal reasons why we do not need this legislation and why it could be interpreted as being harmful. Our antitrust laws are flexible and were meant to be that way.

If the beer wholesalers are, indeed, an industry which needed help, it most likely is that this help could be provided from within the parameters of existing law. Evidently, that is the feeling of Mr. Robert Sullivan, president of the National Beer Wholesalers Association.

The documents attached to my statement indicate that there appears to be some question on just what the beer industry wants regarding this issue. For example, in 1976 when New York State was considering legislation that would mandate exclusive territory for beer wholesalers, both a major brewery and the United States Brewers Association submitted documents which stated opposition to the proposed legislation.

In 1981, at the annual convention, the National Beer Wholesalers were talking about celebrating the passage of Federal legislation on exclusive territories within the year.

In Baltimore, during the fall of 1982, Mr. Sullivan read a statement entitled, "National Beer Wholesalers Association Announces Legal Protection for Exclusive Territorial Agreements Is Now Solid."

According to an editorial in the November 15, 1982, issue of Modern Brewery Age, Mr. Sullivan revealed that all the time and money spent for the Malt Beverage Interbrand Competition Act was apparently wasted because of Supreme Court decisions in the *Rice* v. *Norman Williams*, July 1982 and several subsequent deci-

sions in July and August 1982 have given beer wholesalers, and I quote, "beer wholesalers protection for exclusive territorial agreements."

Recently at a California beer wholesalers convention, Mr. Sullivan stated that the legislative strategy of taking this proposed legislation on as an amendment to another bill would be the only way to get it passed.

While the beer industry appears to be stumbling around trying to figure out if they want the legislation, need it and how to go about getting it, the end result of the passage of this proposed legislation remains concrete. It will cause a disruption in the marketplace, placing licensed beverage retailers in an uncompetitive purchasing position and ultimately resulting in higher prices for the consuming public.

Fifty years ago our country repealed the disasterous experiment of prohibition, and in doing so, enacted strong Federal and State regulation to protect the American public as the sale of alcoholic beverages once again became legal.

Today we sit here contemplating legislation that would exempt a special group from the laws that were designed to protect that same public. We do not need the rebirth of beer barons in our industry or in the American marketplace.

The public interest would well be served by a resounding defeat of this ill-conceived and badly motivated legislation, and just one personal comment, Mr. Chairman, that I would like to make that over the years since this bill was first introduced, I always wondered why it was called the Malt Beverage Interbrand Competition Act. To me, I think the title of the bill should be the Malt Beverage Intrabrand Noncompetition Act. Thank you very much.

Senator DECONCINI. Mr. Protos, in your written statement, you suggest that the bill would eliminate wholesale competition. I have read the statement. You were here when today's witness testified that in South Carolina, where territorial restrictions are now the law, interbrand competition is more vigorous than ever before.

How do you respond to that testimony? Is that false? Are they not telling us the truth?

Mr. PROTOS. Well, I am not a beer wholesaler, sir. I am a retailer. However, I am from Maryland, and Maryland does have a beer franchise law. Actually our State association did support that law.

I think what we are really losing and missing here most is the fact that our position nationally is not to oppose a state-by-state beer franchise law. That is fine. If South Carolina, Maryland wants it, New Jersey, or any other State wants it, that is fine.

But to give a blanket exemption to Federal antitrust laws, and the largest Anheuser-Busch wholesaler in the State of Maryland told me that probably the majority of the beer franchise bills in the States would not withstand the scrutiny of the Justice Department.

Now, to give a blanket exemption, fine, we might have a beer franchise law in Maryland today that we may say is working. Maybe it is not working. That is not for me to say one way or the other.

Senator DECONCINI. Is it working in your opinion?

Mr. PROTOS. In many cases. I could give you a very excellent example of where it is not working.

Senator DECONCINI. Do you think it should be repealed in Maryland?

Mr. PROTOS. I guess I would have to give that a lot of thought, sir, but as I say, with that beer franchise law, we have the right of repeal in Maryland. Once you pass S. 1680, we would not have the right of that repeal of that legislation. Then it could be changed in any way, in any manner that they want.

Senator DECONCINI. It seems to me that the first thing you have got to determine, for credibility purposes, is whether or not it has worked well in the States from which you are. If it has not, then that is very persuasive evidence on that.

Mr. PROTOS. Well, there seems to be, in my experience since we have had it I think 5 or 6 years in Maryland that the majority of people with a beer franchise law in Maryland are happy, but then there are some who are not very happy.

Senator DECONCINI. The weight of the information I have is that it has worked in the State. Maybe that is not enough reason for some people to approve passage of S. 1680, but it certainly indicates that it has not been detrimental. It has been envigorating to competition.

Mr. PROTOS. I do not feel that this is the issue here. Whether a State wants a beer franchise bill or not, that is not the question here. A blanket exemption to an industry to——

Senator DECONCINI. The question is that if it works one place, it is worthwhile expanding to make it work better. Maybe not. But it seems to me like it is a valid question.

If it has worked well in South Carolina, but it has worked well in Maryland, Arizona, and other places, maybe it is a good law.

Mr. PROTOS. But that is not what this bill is doing, sir. This bill is not making a beer franchise law or agreement between the breweries and the wholesalers. This is giving, and the point and my specific objection is that this is an exemption to Federal antitrust laws.

Senator DECONCINI. I understand that. I understand what the bill does.

Mr. PROTOS. I would like to make a couple of comments in regards to what the gentlemen from South Carolina had said earlier. When the beer wholesaler from South Carolina who talks of the agreements, the franchise agreements between the breweries and the wholesalers and the requirements of what service they must give to the retailer and then get into transshipping, I wonder and I ask the question of the same gentlemen, who are the transshippers, who do they buy their beer from, and why are not the same restrictions put on by the breweries to the transshippers as they do to the small independent wholesaler. The breweries certainly know who the transshippers are, and they are selling them the beer.

Senator DECONCINI. Thank you very much for your testimony gentlemen.

[The following was received for the record:]

STATEMENT OF
MATTHEW PROTOS, PAST PRESIDENT
NATIONAL LICENSED BEVERAGE ASSOCIATION
ON S. 1680, THE MALT BEVERAGE INTERBRAND COMPETITION ACT
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY
MAY 22, 1984

Mr. Chairman and members of the committee, my name is Matthew Protos, and I am here today speaking as the past president of the National Licensed Beverage Association in opposition to S. 1680. I appreciate the opportunity to present our views at this time.

The National Licensed Beverage Association is a non-profit trade association with headquarters in Alexandria, Virginia. We offer services in public affairs, education and research to our more than 30,000 members, who operate licensed beverage retail establishments across the country--such as cocktail lounges, restaurants and taverns.

The majority of these small businesspeople have a deep concern about the consequences of S. 1680 if it should become law. They are very worried about the detrimental effect it will have on their businesses, their livelihood, and their families.

Their major concern is that neither the small businessman nor the American consuming public would be served best by granting special exemption of the antitrust laws of our nation to a self-interest group. This action would create "beer barons" throughout the marketplace. In fact, we view this type of legislation as harmful to the consumer and to the retailer, because it would put <u>your</u> stamp of approval on a monopolistic situation.

We are afraid that a favorable recommendation by this committee and the ultimate passage of this proposed legislation would create many negative situation for which the American consuming public will pay the price.

First, granting a self-interest group special exemption to the antitrust laws will surely open pandora's box and encourage every other self-interest group to seek similar treatment. After all, a legal monopoly could be very lucrative. Already, other organizations are waiting in the wings to see what action is taken on S. 1680. There is no doubt in my mind that if the beer wholesalers receive favorable action on this legislation, the wholesalers of distilled spirits and wines will attempt to amend the bill or will submit legislation of their own granting them this same privilege.

It is my understanding that the Sherman Act was written to prevent large monopolies from forming and to foster free competition in the marketplace--the cornerstone of our very successful free enterprise system. NLBA fails to see why one industry should be exempted from laws by which all other American industries must abide.

Let's not forget that antitrust laws were enacted for the protection of the small businessman and the consuming public. In this case special exemptions to these laws can only take away that protection and lay open the small businessman and consuming public to the whims of beer wholesalers who would have exclusive rights to sell their brand of beer to retailers within the boundaries of their kingdoms. As in any feudal economy, this one too would be supported on the backs of the "peasants"--in this case, the consumers.

In reality this has already happened. Just a few years ago, Congress set a precedent by allowing the soft drink industry exemptions to antitrust. Today we have proof that others will seek this exemption: That is why we are here.

Granting wholesalers an exemption to the antitrust laws of this country will lead to the elimination of wholesale competition and would place the retailer at the mercy of, in this case, the beer wholesaler. When you eliminate competition, you upset the marketplace. Eliminating competitive pricing will allow a sole wholesaler to dictate his price within his kingdom.

Another concern is that if Congress approves this legislation, it will increase the pressure on many state legislatures to pass exclusive territory laws. Some states have exclusive territory laws at the present time. Whether they are legal under current antitrust laws is a matter for the Justice Department to determine. But we can illustrate the havoc they have caused retailers in the American marketplace.

First, in ever-increasing numbers, beer wholesalers are becoming multiple brand distributors. This means that a wholesaler can carry beer from five or six different breweries--often two of the top-selling brands in the country. Under exclusive territory laws, a wholesaler may carry this variety of brands on his truck, but he does not have the same exclusive territory for all of these brands. This situation places the retailer in an unfair competitive position.

Here is what happens. When a wholesaler's truck pulls up to the retailer's establishment, under exclusive territory laws he can only buy the brands off the truck for which that wholesaler holds the territorial rights for his location. Because of exclusive territories, the retailer must buy some of the brands already riding on that truck from other wholesalers. Often the retailer's cost for those brands is much higher than the price charged by the wholesaler with his truck at the retailer's front door. This higher price is understandable in situations where the wholesaler with territorial rights for a particular brand is shipping the product a greater distance.

Since breweries usually assign territories along county lines or major highways, a retailer on one side of the road may pay more for a brand of beer than his competitor across the same highway is paying for the same brand. If this all sounds very confusing, you're right, it is. So you can imagine the plight of the small retailer who is trying to operate his business under such circumstances.

When legislation dictates purchasing restrictions on any retailer, it limits his ability to function under normal business conditions to purchase at the most favorable price. That lack of ability to follow traditional purchasing guidelines results in higher prices and higher operational costs for the retailer--and ultimately higher prices for the consuming public.

Exclusive territorial agreements cause such situations to exist on a frequent basis and leave the retailer no choice but to pay higher prices for a brand or not to carry that brand. This brings us to "product loyalty." Product loyalty is very strong and indicates how well the major breweries have done in marketing their products. In fact, it is so strong that retailers don't sell a brand as much as they sell their establishments as the best place to buy that brand. In our industry, intrabrand price competition plays a larger role in establishing a competitive resale price than in other industries. Thus, we have the American consumer who will end up paying the increased price rather than switching brands.

This also brings up the question of availability. If my exclusive wholesaler runs out of my customers' favorite brands, or if a strike, natural disaster--such as a flood or electrical failure--prevents my wholesaler from delivery, I would be prevented from looking for another source of supply.

There are purely legal reasons why we don't need this legislation and why it could be interpreted as being harmful. Our antitrust laws are flexible and meant to be that way. If the beer wholesalers were indeed an industry which needed help, it is most likely that this help could be provided within the parameters of existing law.

Evidently that is the feeling of the president of the National Beer Wholesalers' Association. The documents attached to my statement indicate that there appears to be some question on just what the beer industry wants regarding this issue. For example, in 1976, when New York State was considering legislation that would have mandated exclusive territories for beer wholesalers, both a major brewery and the United States Brewers Association submitted documents which stated opposition to the proposed legislation. (Attachment A)

In 1981 at the annual convention, the National Beer Wholesalers were talking about celebrating the passage of federal legislation on exclusive territories within the year.

In Baltimore during the fall of 1982, the current president of their association read a statement entitled, "National Beer Wholesalers' Association announces legal protection for exclusive territorial agreements is now solid." According to an editorial in the November 15, 1982, issue of Modern BreweryAge, their current president also revealed that all the time and money spent on lobbying for the Malt Beverage Interbrand Competition Act was apparently wasted because the Supreme Court's decision, in Rice vs. Norman Williams (July, 1982), and several subsequent court decisions in July and August of 1982 have given "beer wholesalers protection for exclusive territorial agreements." (Attachment B)

Recently at a California Beer wholesalers convention, President Sullivan of the National Beer Wholesalers Association stated that the legislative strategy of taking this proposed legislation on as an amendment to another bill would be the only way to get it passed. (Attachment C)

While the beer industry appears to be stumbling around trying to figure out if they want the legislation, need it and how they are going to get it, the end result of the passage of this proposed legislation remains concrete. It will cause a disruption in the marketplace placing licensed beverage retailers in an uncompetitive purchasing position and ultimately result in higher prices for the consuming public.

The limits placed on the beverage alcohol industry are many and well-documented. This industry is well-regulated at both the federal and state levels. The three-tier system of distribution regulates competition among distributors. The National Licensed Beverage Association believes that these proposed additional limits on competition in S. 1680 would help the first two levels of distribution to the detriment of the third level--the retail level--the level of our members. In addition, this bill would limit competition to the detriment of the consumer who, in the final analysis, will pick up the extra tab.

The proponents of this legislation would lead us to believe that their industry is threatened by transshipping and that this special waiver of the antitrust laws is needed to save the industry. Let me state that transshipping is nothing new to the beer business. It has gone on for years, often by one wholesaler within his own area. This is especially true in summer resort areas where large inventories of beer are picked up at the end of the season and dumped on other accounts which remain open throughout the year. There are laws to regulate the sale of alcohol beverages across lines of particular government jurisdictions and the disadvantages of transshipping within a designated area can best be controlled by self-regulation and self-policing within the industry.

Proponents of this legislation further state that transshipping affects the consumer because transshipped beer has often exceeded its shelf life and the consumer is sold old beer. Yet to my knowledge only one major brewery clearly indicates the brewing date of its product on the container. Other breweries use a label code which is indistinguishable to the consuming public and to the retailer, for that matter. If stale beer is the issue here, why isn't the

brewing date made available and clearly marked on the container as is done with so many other products we purchase today? The truth of the matter is that the passage of S. 1680 will provide the wholesalers with "beer baron" kingdoms at the expense of both the small licensed beverage retailer and the American consuming public. The possibility of stale beer is no excuse to undermine sound law.

Fifty years ago, our country repealed the disastrous experiment of Prohibition and, in doing so, enacted strong federal and state regulations to protect the American public as the sale of alcohol beverages once again became legal. Today we sit here contemplating legislation that could exempt a special group from laws that were designed to protect that same public. We do not need the rebirth of "beer barons" in our industry or in the American marketplace. The public interest would well be served by a resounding defeat for this ill-conceived and badly motivated legislation.

BOND, SCHOENECK & KING

ATTORNEYS AT LAW

ONE LINCOLN CENTER

SYRACUSE, N. Y. 13202

Phone (315) 422-0121

ALBANY OFFICE
111 WASHINGTON AVENUE
ALBANY, N. Y. 12210
PHONE (518) 462-7431

Attachment A

March 22, 1976

MEMORANDUM IN OPPOSITION
ON BEHALF OF THE
MILLER BREWING COMPANY

S.7524-A Stafford - A.11352 Griffin

AN ACT to amend the General Business Law to add a new article regulating franchise contracts for the sale of beer.

The MILLER BREWING COMPANY strongly opposes this bill.

If enacted, this bill would grant territorial monopolies for the sale of beer to present beer wholesalers. Entry into the beer wholesale business would be restricted to those already in it. The bill permits a beer wholesaler to sell his business to anyone willing to pay the price sought by the franchisee. The franchisor would have to consent to the transaction or be forced to buy the franchise back from the franchisee for its "fair market value." Franchisors would find themselves in the business of buying up their own franchises or else accepting as their representatives, franchisees short on business ability and lacking knowledge of the industry.

The bill would restrict competition between brands. Many of the speciality, imported and marginal brands would be forced out of the New York State market. Concentration of market power would follow and, with it, higher consumer prices and reduced consumer choice.

In effect, this bill and similar "franchise protection acts" are straight-jackets that bind brewers to wholesalers while at the same time relieving wholesalers of their responsibility to operate satisfactorily as representatives of brewers. By perpetrating the status quo, monopolies are created which prevent new persons from becoming beer wholesalers. The real objective of this bill and of franchise protection laws in general, is special interest favoritism, granting wholesalers a perpetual hold on the distribution of products and foreclosing by legislation any competition.

Wholesalers without competition or incentive might become complacent in dealing with retailers. Service deterioration would result and lead to deterioration of wholesaler-brewer relationships. The absence of competition would inevitably precipitate a price rise.

Recent decisions in Nebraska and Missouri have invalidated franchise protection laws and regulations.

On July 18, 1974 in the consolidated cases of United States Brewers Association, Inc. v. Nebraska and Joseph E. Seagram & Sons, Inc., et al v. Nebraska, 220 N. W 2d 544, the Nebraska Supreme Court unanimously reversed a lower court decision and held that the Nebraska statute regulating franchises between manufacturers of alcoholic beverages and their distributors was invalid as an unconstitutional impairment of the rights of manufacturers to terminate distributorships, establish additional distributorships, and market their products. In the opinion, Justice Boslaugh stated, ". . . the act in question is an unreasonable invasion of the personal and property rights of the plaintiff and must be declared unconstitutional."

The Missouri Supreme Court reached a similar result on March 12, 1975 in Brown-Foreman Distillers Corp, et al v. Stewart, 520 S. W. 2d 1. In that case, the court upheld a lower court case which invalidated on constitutional grounds portions of an administrative regulation which purported to regulate termination of liquor franchises. The lower court held that the regulations were so vague and ambiguous that they were constitutionally offensive.

The inherent right of persons to contract with others is a principle of Anglo-Saxon law. Contracts are voluntary relationships mutually undertaken and the state should not impair that relationship.

Economic paternalism is abhorrent to our concept of free enterprise. Brewers and wholesalers should be free to negotiate their own franchise agreements. Brewers should be accorded the same freedom in selecting wholesalers accorded manufacturers of other products. They should not be discriminated against.

The sale of beer is already highly regulated. If beer wholesalers fear coercion from brewers, present federal and state antitrust laws, as well as beverage control laws and regulations provide adequate protection. No wholesalers, to our knowledge, claim or have claimed that present laws are inadequate to protect them from coercion.

The bill purports to maintain the quality of beer. This is nonsense. The best way to maintain the quality of beer is to insure free competition. No brewer could remain in business very long if its beer was not of consistent high quality.

The bill should be defeated.

United States Brewers Association, Inc.
EXECUTIVE PARK TOWER, STUYVESANT PLAZA, ALBANY, N.Y. 12203

(518) 459-4551

DANIEL J. ADAMS
VICE PRESIDENT - NORTH EASTERN REGION

MAY 3, 1976

MEMORANDUM IN OPPOSITION
on behalf of the
UNITED STATES BREWERS ASSOCIATION, INC.

S. 7524-A, Stafford A. 11352-A, Griffin

AN ACT to amend the General Business Law to add a new article regulating franchise contracts for the sale of beer.

The United States Brewers Association, Inc., the nation's oldest incorporated trade association, representing New York State s newest corporate brewing citizens The Joseph Schlitz Brewing Company, and Miller Brewing Company, and other brewe selling over 90 percent of the nation's beer production, strongly opposes this bill.

This bill would restrict the beer wholesale business to approximately 160-180 N.Y.S. Class C licenses, while granting territorial monopolies to these businesses. The above presently wholesales approximatelv 84.5 percent of the State's beer business which is valued at about $633.15 million. They average 5.8 beer brands and 35.6 assorted packages of beer per business. Twelve N.Y.S. counties do not have a wholesale beer business in operation. 267 brands are authorized for sale in N. Y S. This bill, while granting exclusive control of 267 beer brands to 160-180 businesses forecloses competition, and perpetuates the status quo.

There are approximately 448 other Class C licensed businesses who sell at retail, and approximately 43,861 on and off premise licensees who sell at retail. Licensed businesses could only buy beer from the proposed wholesale franchise distributor, or the primary distributor in a designated area. 160-180 "primary distributors" may become complacent in dealing with "out of the way" or "small purchase" retailers. The bill is not in the best interest either of the "large purchase" retailer who sells at minimum markup, for he becomes subject to purchasing from the monopolistic beer wholesaler.

In turn, the consumer market, under the absence of brand purchasing competition, inevitably rises.

Concentration of brands or reduced consumer choice follows. Wholesale beer distributors are overwhelmingly multi-brand distributors. It is a marketing impossibility for a multi-brand wholesaler to sell all authorized brands of beer to all licensees authorized to sell beer at retail who are located in the franchisee's

sales territory. Many imported, speciality and/or marginal brands would be forced out of the New York State malt beverage market, adding to concentration of market and domination of the New York beer market by those brands the "franchisee" seeks to aggressively market. A 100% distribution rate for 267 brands by 180 wholesalers selling 44,309 licensed accounts is delusive.

The bill grants the right to the beer wholesaler to sell his business to anyone willing to pay the price sought by the "franchisee". A "franchisee" could sell to anyone lacking financial and industry knowledge, or business and management ability. Conversely, two new state brewing operations, investing approximately one-half of a billion dollars in New York State would have to accept as a wholesaler anyone, or be forced to buy the franchise for its "fair market value".

The bill requires that the brewer must provide the wholesaler with at least 90 days prior written notice of an intent to terminate. In this three month time, a disgruntled wholesaler could impair or destroy a brand's image, reputation, availability and future prospects.

The brewer members of the United States Brewers Association, Inc., want and seek stability in their distributor relationships. Individually, they provide their respective wholesalers equity or franchise agreements. Contracts are voluntary, mutually undertaken and for nearly two centuries, brewers and wholesalers have both profited. No justifiable cause can now be served by the State choosing sides and injecting itself into mutually agreed upon business transactions.

In summary, the bill states its intent is to assure a constant supply of fresh and wholesome beer to the consumer. The efficient, well managed beer wholesaler now performs in this manner.

Yet, this concern in the market place, is an internal brewer/beer wholesaler industry problem. It can be effectively dealt with, without passage of S. 7524-A, A. 11352-A.

The United States Brewers Association, Inc., offers its assistance to the New York State Beer Wholesale industry, and to those who govern the beer industry, toward responsible and equitable action to solve the problems relating to overage merchandise.

U. S. B. A. strongly urges the defeat of S 7524-A; A 11352-A, yet its introduction has served a useful purpose in that it has informed the legislature of brewer/wholesaler relationships and brought to light inter-industry concerns. In correcting these concerns, the industry can unite and work in harmony toward solutions.

N. Y. S. Beer Wholesalers and the N. Y. S. staff of the United States Brewers Association, Inc., have always worked together and in harmony. There exists a mutual trust and respect. The Regional Vice President, United States Brewers Association, Albany, places himself at the disposal of the wholesaler and brewer, and offers to act as an intermediary on behalf of those seeking assistance to affect improved and equitable relations.

MODERN BREWERY AGE, November 15, 1982

NLBA-
ATTACHMENT B

editorial

The "New NBWA" or...

Hot Air Over Falls Church

During the past year, the philosophy of NBWA Executive Vice President Bob Sullivan and the "New National Beer Wholesalers' Association" has emerged. The basic tenets of this philosophy include: (*A.*) if you don't like something, pin the blame on someone else (i.e. the Wholesale Beer Association Executives, Ralph Nader, the brewers, Senator Metzenbaum, the trade press, supermarket chains or the boogeyman); (B.) to describe what you haven't accomplished, use a lot of grandiose adjectives (i.e. stupendous, momentous, colossal, amazing, supercalifragilisticexpialidocious); and (C.) when all else fails, tell your members that all their problems are solved (i.e. the Malt Beverage Interbrand Competition Act was apparently just another NBWA seminar called: "Congress in Action").

This new philosophy was very much on display at the NBWA convention in Baltimore. On Tuesday of convention week, Bob Sullivan breathlessly read a statement entitled: NATIONAL BEER WHOLESALERS' ASSOCIATION ANNOUNCES LEGAL PROTECTION FOR EXCLUSIVE TERRITORIAL AGREEMENTS IS NOW SOLID. He revealed that all the time and money spent on lobbying for the Malt Beverage Interbrand Competition Act was apparently wasted because the Supreme Court's favorable decision in *Rice vs. Norman Williams* (July, 1982) and several subsequent court decisions in July and August of 1982 have given "beer wholesalers protection for exclusive territorial agreements."

Curiously, the U.S. Justice Department and the Federal Trade Commission had both used very similar arguments in opposition to the beer bill at congressional hearings throughout the summer of 1982, both before and *after* the *Williams* decision.

The FTC's Walter Winslow testified at a Senate Judiciary hearing in August that:

Proponents of S. 1215 have also cited as a justification for the legislation the uncertainty created by a California case that applied a per se standard to a vertical restraint in the liquor industries. The Supreme Court has recently decided that case, Rice v. Norman Williams Co., and reversed the decision of the California court in such a way as to eliminate any fears that companies in the malt beverage industry might have had.... The point to remember is that if a brewer or malt beverage wholesaler were to be charged with an illegal exclusive territorial arrangement, the Government or plaintiff in order to prevail would have to prove that the overall effect of the arrangement was unreasonably anticompetitive. Although there may be some uncertainty for brewers and malt beverage wholesalers—just as there may be some uncertainty for companies in any other industry—the Commission believes that the advantages of using the flexible rule of reason test outweigh such uncertainty.

The NBWA position was spelled out by Seymour Podolsky in June before the *Williams* decision. He argued then that:

Antitrust litigation conducted under rule of reason principles is inevitably lengthy, burdensome and expensive. Such litigation requires a detailed examination of the specific conditions and circumstances of each of the particular local markets involved. Elaborate discovery and the presentation of expert economic testimony are virtually unavoidable. Even where, as in cases involving the distribution of malt beverages, the ultimate reasonableness of the vertical agreements appears clear from the outset, a court cannot realistically be expected to resolve the issue without long proceedings and often a lengthy trial. The proposed Act would serve the public interest by confirming the lawfulness of territorial agreements, by adding to the law an important and necessary degree of certainty, and by avoiding the costs and burdens of needless litigation.

In August, a month after the *Williams* decision, Raymond Justak and Matthew Dee, testifying on behalf of NBWA, reiterated Podolsky's remarks. Dee mentioned two antitrust cases in Indiana, *Arth Main Street Drugs vs. Beer Distributors of Indiana and Tippecanoe Beverages vs. BDI, et. al.* Since 1977, 135 wholesalers have spent approximately $300,000 defending themselves.

At the same hearing, USBA lawyer Dick Riddell also contested the contention of the Justice Department and the FTC that the *Williams* decision provided adequate protection. He claimed that a wholesaler would have to spend thousands of dollars in legal fees and years in litigation to defend his innocence under the antitrust laws.

Bob Sullivan, himself, told reporters at the NBWA convention that suits would still probably be brought but he felt that they would be neither successful nor very lengthy. He never mentioned the costs that these suits would generate for wholesalers even if they ultimately won.

On the same day as NBWA's startling announcement, G. Heileman President Russell Cleary speaking on the same program also noted the changing legal climate and his company's intention to write wholesaler agreements similar to the new Anheuser-Busch Wholesaler Equity Agreement. But Cleary still was concerned about possible costly litigation for wholesalers and brewers. He expressed strong support for Operation Independence and urged wholesalers to push for state territory laws as well.

Rather than the changing legal climate, NBWA's abrupt turnaround was more likely brought about by the unpleasant realization that the bill wasn't going anywhere this year. At the 1981 convention, Sullivan had promised wholesalers that they would be celebrating the bill's passage in Baltimore. As late as September 27, 1982, NBWA lobbyist Rick Thornburg said that he had "a gut feeling" that the bill would be passed by the House before October 5. Rather than facing up to that failure, Sullivan waved a public relations wand and told wholesalers that all their troubles were over thanks to the good ol' NBWA.

The beer bill's lack of progress is matched by the sorry state of NBWA's much vaunted political action committee. At the 1981 convention, a first year goal of $250,000 was announced but only $65,000 has been raised to date.

The "New National Beer Wholesalers Association" has a gaudier veneer than the old one but the tactics, rhetoric and results have changed very little. NBWA's relations with other industry groups have returned to the childish, counterproductive chaos of the pre-Sullivan era.

Until something more tangible than hot air emanates out of Falls Church, Va., Sullivan and company should quit bragging about nonexistent triumphs and concentrate on developing an organization that can deal with the ever multiplying problems that beer wholesalers face, ranging from transshipping to excise taxes. Part of that solution is going to have to include more cooperation with the various state wholesaler associations and the executives that direct those groups. If that ever comes to pass, Bob Sullivan will have something legitimate to brag about.—Terry Calhoun

MODERN BREWERY AGE, January 31, 1983

editorial

Baltimore Revisited

The first major state wholesalers convention of the year, the Minnesota Beer Wholesalers Association meeting, recently concluded. Anyone who had also attended last fall's National Beer Wholesalers Convention had to have left Minneapolis a little confused.

As many of you may recall, NBWA Executive Vice President Bob Sullivan told the membership at the fall meeting that "the major battles to establish legal protection for territorial agreements are over." The need for the Malt Beverage Interbrand Competition Act was largely nullified by several court decisions, he said. As further evidence that the bill was no longer necessary, in his opinion, Sullivan cited the Anheuser-Busch Wholesaler Equity Agreement as proof that the threat of lawsuits was now negligible. If other brewers were to implement similar contracts, beer wholesalers would have nothing to worry about, said Sullivan. He then announced that he personally would conduct a grand tour of the major brewers, urging them to adopt A-B type agreements.

The Minnesota meeting gave an inkling of what kind of a reception Sullivan must have gotten from various brewery presidents.

G. Heileman Brewing Co. President Russell Cleary's position on interbrand has not changed one iota since well before that eagerness announcement in Baltimore. He continues to strongly urge passage of the national bill. If that effort fails, then as a fallback position, Cleary thinks legislation on a state-by-state basis should be obtained.

Cleary reminded the wholesalers that A-B's contract will probably be challenged in court. Any lawsuit against A-B will also include wholesalers. Even if such a suit eventually failed, the costs could be substantial. Anheuser-Busch is one of the largest corporations in this country, with tremendous financial and legal resources at its disposal. No wholesaler is in that position.

In case Cleary's warning was not enough, an Anheuser-Busch representative echoed his remarks at the next general session in Minneapolis.

Michael LaMonica, A-B's vice president of marketing operations, said that his company "fully supports passage of the Malt Beverage Interbrand Competition Act" because the legislation "would firm up this entire area of the law." Even though A-B's lawyers had carefully researched the exclusive territory amendments to their contract, "such clarification would be desirable."

Bob Sullivan at last year's NBWA convention

LaMonica went even further than Cleary, stating that in addition to passage of the national bill, companion territory legislation on the state level was also needed.

Right now, one of the worst kept secrets in the brewing industry is that NBWA plans to re-introduce the Malt Beverage Interbrand Competition Act in Congress. Unfortunately for wholesalers, this reversal may have come too late. Opponents of interbrand, such as the National Licensed Beverage Association, already have heard about Sullivan's startling announcement in October. If members of Congress have not, you can bet that NLBA and others will point to this waffling as a good reason not to vote for the bill. If the authors of the bill themselves have expressed disinterest in their own legislation, why should members of Congress bother to support it?

And what of its chief sponsor in the House? How has Sullivan's rug-pulling act affected Representative Jack Brooks' attitude toward the NBWA's Interbrand Competition bill? According to a spokesman in Rep. Brooks' office, the congressman "has not yet made his mind up" on whether or not he will reintroduce the bill in this session of Congress.

In the months preceding and since the fall convention, NBWA has worked hard to push the United States Brewers Association and the Wholesale Beer Association Executives into the background as much as possible.

NBWA wants to be "the voice of the beer industry." NBWA's leaders should keep in mind that responsibility and accountability go along with that position. If the Malt Beverage Interbrand Competition Act does not pass this time around, NBWA will certainly stand alone.

—*Terry Callahan*

NLBA Attachment C

rn brewery age
weekly news edition

NORWALK, CONNECTICUT 06855 May 7, 1984

MINISTER Garret FitzGerald of Ireland (left) is greeted by F. Kinsey, president of the Guinness-Harp Corp., at a recent on in the Capitol Building in Washington. The reception fol the Prime Minister's speech before a joint session of Con-

hol free Texas Light sold nationally

e Light, a non-alcoholic everage distributed na- and in Canada, will soon ilable in 12-ounce non-re- ie bottles.

rding to Jacquie Bobbe, nt of J&B Associates, arketers of the brand, the t, which had only been le in cans, should be pack- n bottles by early next

cohol content by weight is less than one-half of one percent.

After four years of distribution of Texas Light in Canada, the brand was introduced to U.S. drinkers last July. In less than a year, the brand accomplished national distribution. Asked about further expansion outside Canada and the U.S., Bobbe said it was possible, but that the company would first like to "maintain success in the U.S."

Distributed by soft drink and food distributors, Texas Light is brewed by the Pearl Brewing Co. in San Antonio, Tex.

l Day All Night

th

e Light contains 68 calo- 12-ounce serving. The al-

n and union nd contract

Stroh Brewery Co. re- reached an agreement he United Steelworkers on a three-year contract ion at three of the com- container plants. The pact about 1,000 employees at mpany's plants in Winston- N.C.; Oak Creek, Wis. and orth, Calif.

chesman for the brewery egotiations between two . Teamsters Union locals roh brewers, bottlers and are still taking place.

NEWS UPDATE...

MO. GOVERNOR SIGNS BREWERY BILL

The Governor of Missouri recently signed into law a bill which would eliminate the possibility of Anheuser-Busch losing its brewer's license if a former director is convicted on federal charges (see MBA Tabloid, March 5, 1984).

Gov. Christopher Bond approved the bill, which while increasing fines to breweries for employees' illegal activities, erases a Prohibition-era law authorizing the closing of a brewery after such actions.

A-B, which lobbied in favor of the bill, has said it sought to have the law changed even before former company Director Paul Thayer was charged with leaking inside corporate information.

Thayer and eight codefendants, meanwhile, recently filed documents denying any wrongdoing.

Sullivan at CBWA convention:

Passage of Interbrand uncertain

The fate of the Malt Beverage Interbrand Competition Act may depend on the outcome of legislative approval of another bill, with the act attached as an amendment.

Speaking at the recent California Beer Wholesalers Association annual convention in Coronado, Calif., National Beer Wholesalers Association President Robert W. Sullivan said beer wholesalers are continuing to study the possibility of Operation Independence passage via this popular political tactic.

With the House and Senate expected to recess by early summer, approval of H.R. 2262, the Malt Beverage Interbrand Competition Act, is not certain. The legislative strategy of tacking the amendment to another bill, Sullivan said, would be the only way to get the beer bill through at this time.

During his speech to the California wholesalers, Sullivan said the biggest enemies to beer wholesalers are neo-prohibitionists, chainstores and other alcoholic beverage industries.

William F. Smith, president of the Pabst Brewing Co., keynote speaker at the convention, said the beer industry needs to get back to the grassroots of selling beer. He told the wholesalers that the industry has been getting "lazy," and that this was a result of the increasing amount of money brewers are spending on advertising their products.

Ft. Collins plant gets voters' o.k.

Anheuser-Busch Inc. won voter approval in Ft. Collins, Colo. last week for an annexation that would allow construction of a new brewery in the northern Colorado city.

The tally was 11,829-983 in favor of the annexation. A-B hasn't announced definite plans to build the facility but has said the new brewery would produce about 4.5 million barrels a year and would come on line 36 months after construction begins.

A-B dividends

Anheuser-Busch Cos., Inc., has announced that its board of directors have declared a regular quarterly dividend of 44 cents per share on the outstanding shares of the company's common stock, payable June 8, 1984 to shareholders of record May 8, 1984.

The company also announced a regular quarterly dividend of 90 cents per share on the outstanding shares of the company's preferred stock, payable June 10, 1984 to shareholders of record May 8, 1984.

Heileman begins marketing Blatz LA

Despite a legal battle with Anheuser-Busch Cos., the G. Heileman Brewing Co. recently began marketing its new Blatz LA brand in Milwaukee.

Heileman said it is continuing plans to begin marketing a second LA brand, Carling Black Label LA. While the brewer said marketing of Black Label LA will begin in the near future, no date or marketing areas have been announced.

Heileman is suing A-B in U.S. District Court in Milwaukee, asking the Court to declare that the LA designation is a generic term for low-alcohol beer which cannot be used by A-B as its exclusive trademark. A-B also filed a lawsuit against Heileman in East St. Louis, Ill. to obtain a judgment that LA is a protectable trademark.

Heileman has obtained a temporary restraining order from the Federal Court in Milwaukee ordering A-B not to proceed with its action in Illinois. Heileman said it intends to vigorously pursue its action in Milwaukee.

A similar discrepancy involves A-B and the Stroh Brewery Co. A trial concerning these brewers' battle over use of the initials is to begin today in St. Louis.

Oklahoma increases beer excise taxes

Oklahoma recently increased the excise tax on beer from $10 a barrel to $12.50 a barrel.

The excise hike, which also increases the taxes on wine and spirits, went into effect April 21.

Second class paid at Norwalk, CT

NEWSPAPER

94522 M 494 495
PD DEA 2 PT 1
RONALD C MURPHY
NATIONAL LICENSE NEW 4994
300 N WASHINGTON ST 329
ALEXANDRIA VA 22314 574

Senator DECONCINI. Our next panel will consist of Jay Angoff of Public Citizen and David Greenberg, legislative director, Consumer Federation of America.

Gentlemen, if you will review your statements, we will put in any full statements that you have and the record will be left open also. If you can summarize, please do so.

STATEMENT OF A PANEL CONSISTING OF JAY ANGOFF, ESQ., PUBLIC CITIZEN, WASHINGTON, DC, AND DAVID I. GREENBERG, ESQ., LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Mr. ANGOFF. Mr. Chairman, I am Jay Angoff. I am a lawyer with Congress Watch. I appreciate the opportunity to be here today.

Senator DECONCINI. We are glad to have you here, Mr. Angoff. I know your association very well.

Mr. ANGOFF. You and our organization agree on what is perhaps the most important issue to us in this Congress. Unfortunately we do not agree on this issue. It is not as important as the other issue I am talking about, but it is fairly important to us.

Senator DECONCINI. We are glad to have your testimony even if we are in disagreement. Who knows? Maybe I will educate you, and I know you will educate me.

Mr. ANGOFF. The reason that we are opposed to this bill is that the evidence that we have seen all seems to demonstrate that this bill would raise the price of beer, and our staff here in Washington is made up almost exclusively of beer drinkers. Our members, a huge majority of them drink beer.

Senator DECONCINI. That is a good reason to be against it right there, that is if your employees are beer drinkers and you think it is going to raise the price.

RESULTS OF SURVEYS

Mr. ANGOFF. It is in our selfish interest that this bill does not pass. Let me run through the evidence that I have seen. Prof. Bruce Jaffe of Perdue University did a study of the price of beer when territorial monopolies were prohibited in Indiana. He found that the price of beer went down 8 to 10 percent.

The Indiana Alcoholic Beverage Commission did another study. They found that it went down 20 percent. Prof. Jack Jordan of Seton Hall University in my home State of New Jersey found out that there was a difference in the price of Bud of between 5 percent and 17 percent between where exclusive territories were legalized and where exclusive territories did not exist.

The Columbus, OH, Dispatch did a survey. It was somewhat unscientific, but they did a survey of the price of beer in four States, Ohio, Michigan, and Kentucky where exclusive territories existed and in Indiana where they did not, and they found out that the price of beer was 19 percent, 21 percent, and 31 percent higher in Ohio, Michigan, and Kentucky respectively than it was in Indiana.

An Indianapolis paper, the Indianapolis Star, did a study. They found that there was a 20-percent difference. Then finally the New York City Department of Consumer Affairs did a study this way.

In 1983, New York State passed a bottle bill, that is, it would require a deposit on all bottles and cans both soda and beer, and they expected that the price of both soda and beer would go up by about the same percent, by about the same proportion.

What they found out was that the price of soda went up by about 4 percent, but the price of beer went up by 30 percent. Now, why did the price of soda go up by 4 percent and the price of beer by 30 percent?

Well, the answer seems to be that in December 1983 Budweiser and Miller, and those were the two brands of beer that they surveyed, Budweiser and Miller put in a term in their contracts with their distributors in New York State which required exclusive territories by contract.

One can reasonably argue certainly that the difference between the 30-percent increase in beer and the 4-percent increase in soft drinks was due to that exclusive territory provision in the contract.

A little theoretical background—so that is the commonsense reason that we are against the bill. We think the price of beer would go up.

A little theoretical background. We think the beer industry, in the beer industry it is exceptionally important that exclusive territories are not legalized because there is so little competition on the manufacturer level. If there were 100 different companies making beer and they each had one distributor in the area, that would not matter too much because you still have these 100 companies competing on the manufacturer level.

But what we have in the beer industry is that there are only six companies on the manufacturer level that make over 90 percent of the beer. Anheuser-Busch and Miller together nationwide account for 55 percent.

Now, that is not so bad. I think Budweiser, they happen to make a find product, but I do not think that they should be protected by this legislation. So what you have is a lot of concentration on the manufacturer level. On the distributor level, even more concentration because often one distributor will sell more than one brand of beer.

What it does is it allows the manufacturer to raise his price, the distributor to raise his price, not indefinitely obviously. If you charge $20 a six pack for Budweiser, people are going to buy another brand.

Just like you were saying about Coke and Pepsi, if you charge a very, very high price for Coke, people are going to drink Pepsi. But the important thing to remember is that the beer companies as anybody who has watched the NBA playoffs or the hockey playoffs or the game of the week or USFL football knows the beer companies do a tremendous, tremendous, have a tremendous advertising budgets, and there is a very strong brand preference.

Where I grew up, for example, everybody drinks Budweiser. That is just the way it has been and people are going to continue to drink Budweiser not if it goes up to $20 but Bud can raise its price to a certain extent and the 20-percent average that people have found seems to me to make sense.

That is why in this industry exclusive territories are, we think, particularly inappropriate.

Let me talk just a little bit about the free rider effect which is a somewhat technical argument. This administration, and others, believe in what they call the free rider theory, and that theory holds this.

It says that exclusive territories are not bad, in fact, they are good, because you need exclusive territories to encourage the distributor with the exclusive territory to provide certain services, special services that increase the value of the product to the consumer and the consumer needs and wants, and they say it is unfair for someone else to get a free ride on the efforts of that distributor, that is, it is unfair for somebody from out of the territory to come in and cherry-pick, to reap the benefits of the efforts the distributor with that territory has made.

The typical examples are with computers and stereos, things that require a lot of technical expertise. The typical example is the consumer will go to one distributor. The distributor with the exclusive territory and learn all about computers, learn all about stereos, learn how to use them, listen to the stereo in the fancy showroom, get all this expert instruction, and then he will go to the transshipper, let us say, after he has learned about the stereo or the computer and buy the item at a cheaper price.

Well, some people agree with that theory, some do not. But clearly stereos and computers are a good example if you do believe in that theory. Beer, though, does not hold up. There are no special services associated with beer. The consumer does not have to go to a distributor and learn about beer.

All you need is somebody to sell it and somebody to drink it. So, again, I think in this industry it is particularly inappropriate for exclusive territories to exist.

Finally I would like to mention two arguments that I think are now the major arguments that the proponents of the bill make. The first is the stale beer argument, and I think there are four answers, three or four answers to that.

The first is that there are a lot of, as the previous witness says, there are a lot of far more perishable products that are sold without exclusive territories. If there were a problem, you could just open date the beer and regardless of the method of distribution, it is always in somebody's interest, I think, to sell fresh beer and not stale beer.

Then the final argument is the jobs argument. The Teamsters Union makes this argument the most forcefully, and they say that if you have this bill, if you prohibit transshipping, that it will promote jobs. Well, it will promote Teamster Union jobs. I mean the people who have the jobs now will tend to keep them, that is true, because many of the distributors who would be protected are unionized by the Teamsters.

But that does not mean that if this bill were not, I mean, if we went to a different system, maybe everybody would not be Teamsters Union members, but you would still have to load and unload the beer. Somebody has got to do it. So maybe they would not be Teamsters Union members but they would be members of other unions or maybe nonunion or maybe they would not be unionized, but there would still be the jobs there.

So in conclusion, Mr. Chairman, we just do not think the proponents of this bill have made their case, and particularly I guess from a selfish viewpoint because we believe that it would raise the price of beer, we oppose the bill.

Thank you very much.

Senator DECONCINI. Did your group oppose the soft drink law?

Mr. ANGOFF. Yes, we did not do a very good job of it I am afraid. I think the bill passed the Senate 89 to 3.

Senator DECONCINI. Yes, it did. Senator Birch Bayh managed that bill, and this one, of course, is patterned after it, it is almost identical to it. I sat in on a number of those hearings but I cannot remember if Public Citizen testified or not, and if you did what your position was. I just wanted to note it for the record, because the soft drink people made a good case, and I ended up voting for it.

Mr. ANGOFF. Well, I think they did make a good case, but there is a big, big difference between the soft drink bill, even though we opposed it, they did make a good case. I think a much better case than the beer industry has made.

And the reason is with the soft drinks, that is the way the business had been done nationwide for years, for decades, and the FTC came down with a decision in the late 1970's that outlawed the system that had been the system in the country for decades.

So there was an argument that this is the way that we have always done business. This decision upsets that. The old way has worked all right. Let us go back to it.

The beer industry is entirely different, and the reason is that in some States that is true. There are exclusive territories which are legalized, but in many States, there are not exclusive territories.

What this bill would do would be to change the status quo in many States, in a majority of the States.

Senator DECONCINI. If the FTC ruled in this industry that might give them a little more weight to support. It would not change your position, but it would give them a little bit more merit in their being here.

Mr. ANGOFF. It would probably strengthen their position, yes.

Senator DECONCINI. I have to go vote. We will hear from Mr. Greenberg in about 12 minutes.

[Whereupon, a short recess was taken.]

Senator DECONCINI. We will reopen the hearings, and now we will hear from Mr. Greenberg.

Mr. GREENBERG. Thank you, Senator DeConcini.

I am David Greenberg, legislative director of Consumer Federal of America. I stand in a little bit different posture, I guess, than everyone else this morning. The witnesses so far have either sold beer or bought beer or as Jay says, drink beer. But I am totally objective because I do not drink the stuff nor buy it.

Senator DECONCINI. You are missing something.

Mr. GREENBERG. You finally get a chance to hear the unvarnished truth. I agree with almost every point that Jay made about prices, about the structure of the industry, and about the arguments that have been put forward by the proponents so I would like to save the committee some time and make two points.

One is about reducing legal costs and uncertainty. Senator, as you well know, exclusive territorial arrangements are legal right now by contract. Under the *GTE Sylvania* case, they are only illegal if they have anticompetitive effects.

Thus, one of the few decent arguments that the proponents still have is that this legislation will eliminate some uncertainty, that is "we are small companies. We cannot afford protracted litigation under *GTE Sylvania* to ratify what obviously is going to be a legal practice in an already competitive industry."

I think that argument has some force until you begin to look at the structure of this legislation and what would be required. What we have here is a substitution for the *GTE Sylvania* test of a test of substantial and effective competition with other malt beverage products in the geographic area.

I think if you look at the language and concepts of this test, though, you will see that they offer as much potential for litigation, if not more. Start first with just the general standard of substantial and effective competition.

Now, that is an elastic phrase. It is subject to a variety of judicial constructions and applications, and even the subparts of the standard, substantial, effective, other malt beverage products and defined geographic area, are all ripe for legal interpretation and reinterpretation.

I think these legal terms and the facts to which they will apply are going to require an analysis that is every bit as complex as *GTE Sylvania.*

Really when you think about it, the supporters of this legislation face a familiar dilemma in the legislative process. They could have sought a per se legislative remedy, an over-inclusive remedy that would have provided blanket antitrust protection for all exclusive territories.

But if they did that, they would clearly put some anticompetitive arrangements that either exist now or could exist in the future beyond the reach of the law. Well, that is bad law and it is clearly bad politics, and I do not think Congress would hear of that.

So they took the other option, which is to create a new legal standard and substitute it for *GTE Sylvania.* But I think however permissive that test might be or however different it might be—and no matter what kind of analysis it requires—it is, nevertheless, open to interpretation, and so it is open to litigation.

So I think really as a consequence the argument that S. 1680 will eliminate or reduce litigation costs turns out to be a weak one.

One other point, Senator DeConcini, and then I will close. I would like to talk a little bit about antitrust exemptions generally and the kind of burden they ought to carry in Congress, especially here in the Judiciary Committee.

I think the burden on those seeking legislative antitrust exemptions ought to be particularly heavy. The political momentum behind such an effort often comes from markets characterized by exactly the kind of intense and innovative competition that we all like to see in the market, that is, everyone but the competitors themselves.

There is another political reality which you understand probably better than I do, and that is politically speaking one antitrust exemption has a tendency to beget another one.

In fact, the mathematical relationship may not be simple arithmetic. It may be multiplicative or even logarithmic. In the last couple sessions of Congress, we have seen not only beer wholesalers but doctors, lawyers, shipping companies, office equipment dealers, and travel agents seeking some kind of limited antitrust immunity, following in the footsteps of the soda bottlers' successful 1980 legislative effort.

And it seems to me that once you look at the substance of all the arguments for this bill, really, the one that stands up best politically, even though it does not have much substance to it, is just a "me-too" argument. "Well, the soda bottlers got it and so now we are coming to get it too."

If that is successful with beer, we have got to ask ourselves what product or what sector of the economy is going to step up next and say, "Me too", and not have only one precedent, soda, but two precedents, soda and beer.

So I think it is up to Congress and particularly the Judiciary Committee to declare unmistakably that there is not going to be an open season legislatively on the antitrust laws. If the committee does not, then the antitrust law is going to come to depend more on legislative knowhow and campaign contributions than it does on enduring judicial and economic principles.

So we believe every request for legislative relief from antitrust law has got to be subject to a very thorough and very searching inquiry governed by a heavy presumption against the exemption.

I think on the substance of this legislation, as Jay has suggested and as the last panel has suggested, they have not carried that presumption.

Thank you.

[The following was received for the record:]

Statement of

DAVID I. GREENBERG, LEGISLATIVE DIRECTOR

On Behalf of

CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Judiciary Committee, I am David I. Greenberg, Legislative Director of Consumer Federation of America (CFA).* CFA is grateful for this opportunity to testify on S. 1680, the Malt Beverage Interbrand Competition Act. We oppose this legislation as we opposed similar legislation in the last Congress. In our view, S. 1680, if enacted, would raise prices, reduce competition, and undermine the equal application of antitrust law which helps form the foundation of free and effective markets in this country.

CFA's analysis of S. 1680 will proceed in three parts: (I) Our general position on antitrust exemptions; (II) The likely impact of S. 1680 on industry competition and consumer prices; and (III) An evaluation of the policy arguments offered in support of S. 1680.

I. Antitrust Exemptions

CFA finds itself in complete agreement with the January 1979 Report of the President's National Commission for the Review of Antitrust Law and Procedures, which concluded that antitrust exemptions are appropriate "only where there is compelling evidence of the unworkability of competition or a clearly paramount social purpose."

The burden on those seeking legislative antitrust exemptions must be particularly heavy. The political momentum behind such legislative efforts is likely to be produced in markets characterized by intense and innovative competition. This is the kind of competition favored by everyone, except the competitors themselves.

There is another political reality of enormous consequence that Congress must recall when it deliberates over antitrust exemptions. Politically speaking, one antitrust exemption begets another; in fact, the mathematical relationship

*Consumer Federation of America is a coalition of over 200 national, state and local consumer, senior citizen, labor, cooperative, farm and public power organizations. The collective membership of these groups is approximately 30 million people.

may be multiplicative or logarithmic, rather than additive. In the last two sessions of Congress, beer wholesalers have joined doctors, lawyers, shipping companies, and office equipment dealers in the attempt to emulate the soda bottlers' successful 1980 legislative effort in securing limited antitrust immunity.

This "me-too" philosophy lies at the heart of the beer industry's campaign to enact S. 1680. According to the first line of memorandum provided to CFA by the counsel to the National Beer Wholesalers Association: "The proposed Malt Beverage Interbrand Competition Act would extend to the beer industry the same provisions...the Congress provided the soft drink industry in 1980." As weak as this argument may be substantively, it is powerful politically. And if it is successful for beer, which product or sector of the economy will step forward, this time with not one, but two precedents?

It is up to the Congress--and particularly the Judiciary Committee- to declare unmistakably that there is no legislative "open-season" on the antitrust laws. If it does not, then antitrust law will come to depend as much on campaign contributions and legislative know-how as it does on enduring judicial and economic principles. Thus, CFA believes that every request for legislative relief from antitrust law must be subject to a thorough and skeptical inquiry, governed by a heavy presumption against the exemption. If this Committee agrees, then S. 1680 should be enacted only if it addresses a truly pressing national problem.

II. Legal and Cost Implications of Exclusive Territorial Distribution Scheme Contemplated by S. 1680

S. 1680 would create antitrust immunity for a beer distribution system granting territorial monopolies to the distributors of particular brands. Yet similar territorial arrangements have already passed legal muster with the Supreme Court in the GTE Sylvania case; in fact, exclusive territories are present in today's beer market. Why seek by legislation what is already available by simple private contract?

The proponents of this bill offer several reasons--which we will address in section III--but antitrust experts have a persuasive response of their own. Territorial restrictions which reduce competition will not meet the standards laid down by the Supreme Court in GTE Sylvania. Thus, if the brewers and beer wholesalers forsee that their proposed system of distribution monopolies will raise prices and further concentrate the industry, then they must seek legislation--because their arrangement would not survive antitrust challenges in the federal courts.

Former Assistant Attorney General for Antitrust William F. Baxter made exactly this point last year, calling the risks "uniquely high" that the beer industry "appears to be one in which the ... widespread use of exclusive territories may produce anticompetitive effects." It is critically important to remember that Mr. Baxter is a strong supporter of the GTE Sylvania decision and territorial restrictions. In testimony before this Committee last year, he concluded that "(i)n many, if not most, industries, the structural characteristics of production and distribution significantly reduce the likelihood that exclusive territories will or can be used to generate anticompetitive results....Unfortunately, none of the above mitigating factors is present in the malt beverage industry."

The risks of blanket territorial monopolies in beer distribution are illustrated by the experience of two states with such monopolies. In both New York and Indiana, exclusive distribution for beer has meant higher prices for consumers.

Indiana presents the most compelling case. The state's 1981 Alcoholic Beverage Study Committee found that the price of beer declined 20% with the advent of competition by distributors of the same brand. A 1982 Indianapolis Star survey reported a similar average price differential in comparing competitive distribution and exclusive territories. And the recent research of Dr. Bruce Jaffee, Professor of Business Economics and Public Policy at Indiana University, reached the same conclusion. More importantly, Professor Jaffee's work demonstrates the impact of imposing territorial distribution monopolies on an already concentrated beer industry:

> Not only did local wholesalers not engage in any intra-brand competition until possibly 1977, there was also a remarkable absence of significant inter-brand competition among these wholesalers. The common pricing scheme was to charge the same price for all popular beers, all premium beers, and all super premium beers, regardless of the brand within the category. Prices for all brands within a category were typically changed simultaneously....Thus, it appears that exclusive franchises reduced both intra-and inter-brand price competition."

Less complete evidence from New York is no less convincing. In testimony before the House Judiciary Committee last year, State Attorney General Robert Abrams presented the results of government price surveys from New York City documenting beer price increases of 30% in the first ten months of 1983. According to Abrams, "(t)he grossly disproproportionate rise in beer prices is due in large part to the effects of the distribution monopolies instituted by Anheuser-Busch and Miller Brewing in 1983."

It is critical to understand what the Indiana and New York data prove, as well as what they do not prove. The evidence is strong that exclusive territorial arrangements can lead to higher prices by reducing both intra- and inter-brand competition. On the other hand, the Indiana and New York examples do not lead inevitably to the conclusion that all exclusive territories harm competition. Instead, the experience of these states demonstrates quite simply that distribution monopolies must be examined case-by-case. That is precisely the analysis that GTE Sylvania now requires. It should not be disturbed by a new legislative scheme.

III. Critique of Beer Industry's Policy Arguments in Support of Legislative Territorial Distribution Monopolies

The proponents of S. 1680 put forward three basic arguments in support of this legislation: (1) A legislative solution will eliminate the high litigation costs of applying GTE Sylvania case-by-case to exclusive territorial agreements; (2) Exclusive territories are necessary to assure the delivery of fresh beer; and (3) Exclusive territories are necessary to prevent the damaging consequences of trans-shipping of beer by distributors from other territories. The first is a practical argument which falls down under close analysis. The second and third are policy arguments, neither of which is persuasive; more importantly, both issues are better left to fact-finding by courts.

(1) Reducing Litigation Costs

Supporters of S. 1680 argue forcefully that the many small distributors in the beer industry could ill afford the protracted GTE Sylvania litigation necessary to clarify the status of exclusive territorial agreements. They offer instead a broadscale legislative immunity for distribution monopolies, provided that "substantial and effective competition with other malt beverage products exists." The language and concepts of this proviso, however, offer at least as much potential for litigation, if not more. "Substantial and effective competition" is an elastic phrase, subject to a variety of judicial constructions and applications. Even the subparts of that standard--"substantial," "effective," "other malt beverage products," and "defined geographic area"--are ripe for legal interpretation and reinterpretation. These legal terms--and the facts to which they will apply--are every bit as complex as the GTE Sylvania analysis.

The supporters of this legislation face a familiar dilemma. They could have sought an overinclusive legislative remedy, for example, a blanket antitrust exemption for all exclusive territories. But that remedy would clearly

put some anticompetitive arrangements beyond the reach of the law. It would also put the legislation beyond the limit of political feasibility.

The other option--chosen by the drafters of S. 1680--is to create a new legal standard to take the place of GTE-Sylvania. This legislation adopts "substantial and effective competition with other malt beverage products in that defined geographic area." But, however permissive that test, it is nevertheless open to interpretation, and thus to litigation. As a consequence, the argument that S. 1680 will eliminate or reduce litigation costs turns out to be a very weak one.

(2) Assuring Delivery of Fresh Beer

S. 1680's supporters also insist that exclusive territories are necessary to maintain the quality and freshness of beer. This argument is very difficult to understand. If consumers purchase stale beer from a retailer, they will either exchange it for a fresh six pack or begin buying their beer elsewhere. Either step sends a signal to the retailer, who then has the incentive to demand greater quality control from its distributor. If the distributor fails to live up to that demand, then the retailer can simply change distributors (unless, as under exclusive territorial systems, there is no other distributor of the brand in question).

In other words, normal market forces would appear to be a sufficient safeguard against stale beer. Moreover, competitive distribution seems to have an advantage over monopoly territories in giving sellers the power to demand fresh beer from distributors. In addition, open dating of beer is a more direct response to the stale beer problem, if it exists. Finally, the makers of other foodstuffs for which freshness is a high priority appear to be able to handle the issue without resort to federal antitrust immunity. Like the litigation cost problem, the fresh beer problem hardly needs the attention of the Congress and this Committee.

(3) Preventing the Harmful Consequences of Transshipping

The beer industry has chosen the transshipping issue as the linchpin of its arguments for this legislation. When a distributor transships, it simply sells beer outside its normal geographic market. Yet the National Beer Wholesalers Association accuses transshipers of "encroaching" on the business of legitimate distributors, driving many wholesalers to bankruptcy, and generally causing "disastrous consequences for the brewer, the wholesaler and the consumer." See 3 May 1982 Memorandum Re: Department of Justice Position that the Beer Industry Does Not Deserve the Protection of S. 1215 (S. 1680's predecessor).

Despite these accusations, transshipping appears to be a form of healthy competition. The threat of lower-priced beer from another region will serve to keep distributors from pricing their beer above market clearing prices. And for areas with little or no competitive distribution, transshipping is crucial to cushion the harmful consequences of industry concentration.

Moreover, nothing prevents the "victim" of transshipping in one area from becoming its protagonist in another area. Barriers to entry are relatively low in the beer distribution market, at least compared to barriers to entry in manufacturing. Thus, a distributor can respond to transshipping by becoming a transshipper himself.

Of course, I understand the distributors' frustration regarding transshipping. No one likes to have customers lured away. And, no one enjoys having investment decisions complicated by factors like transshipping that are difficult to assess. But, Richard M. Quinn, the Sales Manager of the Beer Company in Indianapolis, said it best:

> As one who has spent twelve years as a beer wholesaler in Indiana, both as a traditional protected wholesaler and more recently as an aggressive, competitive transshipper, I can state with completed confidence that in my experience A) It is a lot easier to operate in a protected market, and B) In order to survive in the free enterprise system, competition forces one to reduce prices, effect economies in your operation, increase volume, and target specific geographical markets as well as retail account profiles.... In my opinion transshipper is just a negative way of saying competitor.

The courts have a simpler way of stating the issue: The antitrust laws "were enacted for the protection of competition, not competitors." Brown Shoe Company vs. United States, 370 U.S. 294 (1962).

IV. Conclusion

The transshipping argument, like the fresh beer argument, is unpersuasive. In the end, that is beside the point; these issues are for the courts to evaluate. Exclusive territories are perfectly legal as long as they are not anticompetitive. Thus, if the beer wholesalers are correct that exclusive territories will enhance competition, they have little to fear. One or two test cases will be litigated under Sylvania, the courts will set criteria specific to the beer industry and the matter will be closed. That is a far cry from enacting legislation that potentially immunizes territorial monopolies in an already concentrated market, and would inevitably serve to lengthen the queue of industries seeking their own special antitrust deal.

Consumer Federation of America thanks the Committee for the opportunity to appear today. We urge you not to send S. 1680 to the full Senate.

Senator DECONCINI. Thank you, Mr. Greenberg.

You raise a point that is so important, and I just want to underscore it, I have not talked to them all. I would suppose they would just as soon have a blanket exemption from the antitrust but maybe not. They certainly are not getting it here, and you agree with that.

We are setting a substantial and effective competition standard and substituting that standard for the rule of reason. You are correct in observing that there are going to be many interpretations. That is true of any legislation. It seems to me as though we are being very cautious that which you are saying we should be.

We should not just grant this to anyone willy-nilly as they step to the bar of the Judiciary Committee and ask that they be exempt. We are not doing that, and that is why there is a standard to be met there.

Your point then, is that this standard is not strict enough or that it is new and therefore subject to an interpretation which requires litigation and a determination of whether they are living by the standard or both?

Mr. GREENBERG. Well, I guess a little of both. First of all, I am not sure that the standard meets the real problems that the industry representatives have raised.

As Jay suggested, the service parts, the fresh beer parts, the free rider problem, I am not sure that they are met by the substantial and effective competition test.

Senator DECONCINI. Would you suggest another standard?

Mr. GREENBERG. I think the standard that we have right now under the common law is the one that best meets the test. The *Sylvania* decision was precisely about the kinds of issues that are raised in these cases.

If there are problems with exclusive territorial contractual arrangements in this industry, then they ought to be litigated in a couple different kinds of instances.

The courts will then set standards and criteria that are more specific to the beer industry—Sylvania dealt with electronics or some other industry—and then I think everyone would have pretty clear guidelines on which to base investment decisions and carry on their business. They might not be decisions that were exactly to the liking of people who would like to see widespread and uniform exclusive contractual territorial arrangements, but I think that is appropriate because the point of the court review may be that in some instances it will work well and some other instances it will not work well, and I think we are just going to have to live with that uncertainty.

Senator DECONCINI. Do you know if your organization opposes the Soft Drink Interbrand Competition Act?

Mr. GREENBERG. Yes, we did.

Senator DECONCINI. Did you testify in opposition?

Mr. GREENBERG. I do not know if we testified. It was before my time.

Senator DECONCINI. Mr. Agnoff, may I ask you, in that particular testimony, I am just wanting some legislative history that will save my staff from doing a lot of work, you testified. Did you offer any other standard?

Mr. AGNOFF. No, we, as I remember, and that was slightly before my time, too, we supported the FTC decision.

Senator DECONCINI. As is?

Mr. ANGOFF. That is right.

Senator DECONCINI. Would you offer any other standard here to make this better legislation or do you feel as Mr. Greenberg does that we should stand by the existing case law?

Mr. ANGOFF. Well, we think the rule of reason standard as set out by the courts is a workable one.

Mr. GREENBERG. Senator, one more point on that. I think that any standard in a piece of legislation is likely to cause some problem, because even if the staff of the Judiciary Committee attempted to codify the rule of reason analysis in GTE Sylvania, the courts would have a very hard time figuring out whether that was the same thing or a different thing.

Senator DECONCINI. Whenever you pass a law, it is going to be subject to interpretation, and that is part of the process.

Thank you, Gentlemen, very much. We appreciate your testimony.

Mr. ANGOFF. Thank you.

Mr. GREENBERG. Thank you.

Senator DECONCINI. The committee will stand at recess. This will be the final hearing on this bill, I am advised, and subject to the call of the chairman.

Thank you.

[Whereupon, at 12:01 p.m., the committee adjourned at the call of the chair.]

[The following letter was subsequently supplied for the record:]

United States Brewers Association, Inc.

1750 K STREET, N.W. WASHINGTON, D.C. 20006

(202) 466-2400

DONALD B. SHEA
PRESIDENT

TWX 710-822-9208

1984 MAY 24 AM 10 02

1984 MAY 25 AM 11:46

May 22, 1984

The Honorable Strom Thurmond
Chairman, Committee on the
Judiciary
United States Senate
SD-224 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

At the May 22, 1984 hearing held by the Senate Judiciary Committee on S. 1680, the Malt Beverage Interbrand Competition Act, Mr. Matthew Protos, Director, National Licensed Beverage Association, presented in his written and oral testimony allegations which imply that the United States Brewers Association, Inc. (USBA) did not fully support enactment of S. 1680.

Mr. Protos' allegations are based on a USBA memorandum of May 3, 1976, (a copy of which was attached to Mr. Protos' written testimony), which was filed in opposition to legislation in New York State (S. 7524A/A. 11352) to amend the general law in relation to franchise contracts for the sale of beer. This legislation was unilateral in its application of providing franchise rights and obligations to the brewer/wholesaler relationship, granting exclusivity rights in these relations only to the wholesaler, while imposing substantial responsibilities and obligations only on the brewer. The provisions of the New York State legislation dealt with the contractual obligations, responsibilities, and rights of the parties to a franchise agreement, which added to these franchise grants exclusivity rights.

The USBA's opposition to S. 7524A and later its substitute bill, S. 7524B, as well as subsequent franchise proposals considered by the New York General Assembly, was based on the particular franchise and exclusive territory language and provisions in that legislation.

Some provisions of particular concern to the USBA and its members at that time were the granting to a multi-brand wholesaler the right to sell all authorized brands of beer to all licensees authorized to sell at retail within the wholesaler's sale territory, and the right granted to the wholesaler to sell his business to anyone willing to pay his selling price regardless of financial or industry knowledge.

S. 7524A would have merely provided a beer distributor with advantages of protected independence, while shielding him from burdens or disadvantages of that status.

The New York State bill, S. 7524A (or its successor, S. 7524B) coupled franchise grants with exclusivity rights, but it cannot or should not be used as a basis of argument by anyone for or against S. 1680, the Malt Beverage Interbrand Competition Act.

The USBA respectfully requests that this letter be made a part of the official Senate Judiciary Committee hearing record on S. 1680.

Very truly yours,

Donald B. Shea

DBS/ka

APPENDIX

ADDITIONAL SUBMISSIONS FOR THE RECORD

TEXAS ALCOHOLIC BEVERAGE COMMISSION

Post Office Box 13127, Capitol Station, Austin, Texas 78711 *W.S. McBeath, Administrator*

November 7, 1983

The Honorable Strom Thurmond
Chairman, Judiciary Committee
The Senate of the United States
Washington, D.C. 20510

Re: S. 1680, the Malt Beverage Interbrand Competition Act

Dear Mr. Chairman:

I am writing this letter to you in my capacity as Administrator of the Texas Alcoholic Beverage Commission. Coincidentally, I also have the honor of serving as a Vice President of the National Conference of State Liquor Administrators, the association of "license" (i.e., non-monopoly) state liquor control officials, however, it is not in this capacity that I address you, but rather in my capacity as a Texas state official.

The Texas Alcoholic Beverage Commission is the agency of Texas state government charged with the responsibility of regulating all phases of trafficking of alcoholic beverages within the State of Texas, and with the collection of state taxes which are due as a result of importation and marketing of alcoholic beverages in Texas. I have been employed by the TABC (and its predecessor, the Texas Liquor Control Board) for 26 years; I have served as Administrator since July of 1977. In my experience, I can state that any steps which could be taken to more clearly define the territorial limits for the sale of beer would be beneficial to our agency's enforcement and tax collection effort.

Briefly, Texas is composed of 254 counties covering 267,338 square miles. 74 of these counties are wholly dry. Our agency must exercise a great deal of supervision over the movement of all alcoholic beverages throughout the state, and in doing so, relies upon a system of licensing and required reporting to help effect our enforcement effort.

In 1979, the Texas Legislature enacted strongly-written amendments to the Alcoholic Beverage Code which instituted strict three-tier marketing for beer. As an explanation, the three-tier marketing approach means that beer manufacturers may sell only to wholesalers, wholesalers may sell only to retailers, and retailers may sell only to consumers. This requirement greatly assists the TABC in being able to track movements of beer through the marketing chain, and assists immeasureably (when combined with mandatory reporting of shipments and record-keeping of all sales) with audit verification for tax collection purposes. This law subjected beer marketing to requirements similar to those which had been applicable to distilled spirits and wine for many years.

Prior to enactment of the three-tier law, a person was able to hold a wholesale-level license which authorized the holder to sell beer to another distributor, a retailer, or a consumer. This system was ripe - especially in the case where a wholesale licensee had no affiliation with a brewery - to allow large shipments of beer to move out-of-state or to areas of Texas not served by wholesalers who represented certain brands of beer. As one example, non-affiliated wholesalers would purchase large quantities of Coors products from affiliated Coors wholesalers, and then sell the beer to other persons who transported the beer to other states for legal resale; it is important to consider that brewery-mandated quality control requirements were not observed by the transshipper to the detriment of the product itself and to the ultimate

consumer. In this type of example, the manufacturer could do very little to stop the flow of product as long as it was transported legally. This type of "transshipping" was done not only from Texas to other states, but from one area of Texas to another - to locations where Coors, at that time, had no sanctioned franchised wholesalers.

In 1975, the Legislature passed an Act requiring beer manufacturers to designate territorial limits within which each of their wholesalers shall be permitted to sell their brand(s) of beer and providing that such agreements shall be filed with the TABC. In 1983, the Legislature enacted a bill expanding the law on territorial assignments by prohibiting a wholesaler-distributor from "...making sales of any brand of beer outside the sales territory specified in the written agreement." The latest amendment was enacted pursuant to a legislative finding and purpose, as stated below:

> "(c) This Act is promulgated pursuant to the authority of the state under the provisions of the Twenty-first Amendment to the United States Constitution to promote the public interest in the fair, efficient, and competitive distribution of beer, to increase competition in such areas, and to assure product quality control and accountability by allowing manufacturers to assign sales territories within this state."

For your perusal, I have enclosed a copy of House Bill 1889, 68th Legislature, Regular Session, from which I have quoted above. In connection with the above, the Legislature also enacted earlier this year the "Texas Free Enterprise and Anti-trust Act of 1983" which makes clear that exclusive territorial agreements between manufacturers and distributors do not violate state anti-trust laws. Section 15.05(g) of that Act states:

> "Furthermore, nothing in this section [unlawful practices] shall apply to actions required or affirmatively approved by any statute of this state or of the United States or by a regulatory agency of this state or of the United Stated duly acting under any constitutional or statutory authority vesting the agency with such power."

The TABC's ability to scrutinize the marketing and transporting of alcoholic beverages in Texas depends in part upon our ability to rely upon a legally required system of franchising. If the franchising (setting of territorial limits) is complicated by other laws such as federal anti-trust statutes over which Texas and the TABC have no control, then we must use whatever influence we have to urge those responsible to remove those complications if at all feasible. It is my understanding that such constraints have been removed as formerly applied to soft drink manufacturers, and, I would submit, the regulatory effort as applied to alcoholic beverages - products which were once deemed so pernicious as to be banned and are now highly and strictly regulated and taxed - could benefit from similar legislation.

In summing up my personal views of "franchised territories," I would have to conclude that the most important single issue - aside from the regulatory advantages to be gained - would be that brewery-mandated quality control requirements designed to maintain the product in the best possible condition at the time it is bought by the consumer would be enhanced and followed. If beer - a perishable product - is transshipped into an area served by a franchised wholesaler, then it is not fair or equitable to ask the franchisee to look after the quality control of beer on retailer's shelves that he did not sell in the first place.

I urge your favorable consideration of S. 1680, and respectfully ask that this letter be made a part of the record of your deliberations on the bill. I am very appreciative of the consideration you are affording this measure.

Sincerely,

W. S. McBeath

WSM:cl

Enclosure

NATIONAL
GROCERS
ASSOCIATION

Headquarters Office
1825 Samuel Morse Drive
Reston, Virginia 22090

Public Affairs Office
1910 K Street, N.W., Suite 700
Washington, D.C. 20006

(703) 437-5300

November 7, 1983

The Honorable Strom Thurmond
Chairman
Senate Judiciary Committee
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

The National Grocers Association is a national non-profit trade association representing over 1600 independent retail grocers and 66 retailer-owned cooperatives who serve over 28,000 independent retail food stores. N.G.A. members serve consumers in every type of community -- urban, inner city, suburban, and rural -- by operating supermarkets, small and medium size grocery stores and convenience stores.

N.G.A. members, as distributors of malt beverages to consumers, wish to express opposition to the Malt Beverage Interbrand Competition Act, S. 1680, sponsored by Senator Barry Goldwater. N.G.A. believes there is no need for special legislation that specifically exempts from the antitrust laws the vertical territorial restrictions maintained in the malt beverage distribution industry. Territorial restriction clauses under the antitrust laws have been held valid by the courts where interbrand competition is promoted. Deficiencies in the antitrust laws, if they exist, should not be corrected on an industry by industry basis.

N.G.A.'s position on S. 1680 is consistent with the Department of Justice's Antitrust Division, which has stated, "While we recognize that this language is intended to 'clarify' the applicability of the antitrust laws to exclusive dealing arrangements in this industry, no such clarification is needed. The Supreme Court adopted an entirely sensible rule of reason approach to exclusive vertical territorial agreements in Continental TV, Inc., v. G.T.E. Sylvania, Inc."

On behalf of N.G.A.'s over 1600 independent retail grocers and 66 retailer-owned cooperatives, I respectively request the inclusion of N.G.A.'s views in the hearing record on S. 1680.

Sincerely,

Thomas F. Wenning

Thomas F. Wenning
Executive Vice President
and General Counsel

STATE OF NEW YORK
DEPARTMENT OF LAW
TWO WORLD TRADE CENTER
NEW YORK, N.Y. 10047

ROBERT ABRAMS
ATTORNEY GENERAL

December 1, 1983

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
The Capitol
Washington, DC 20510

Re: Malt Beverage Interbrand Competition Act
(S. 1680)

Dear Senator Thurmond:

I am writing to present to the Judiciary Committee my views on S. 1680 ("the Malt Beverage Interbrand Competition Act"), a bill that would create an antitrust exemption for certain exclusive territorial arrangements in the malt beverage industry. After careful consideration of the bill and of previous testimony before your Committee and the House Judiciary Committee on this proposed legislation, I strongly oppose its enactment for the following reasons.

The proposed legislation is designed solely to provide one segment of one industry with license to eliminate competition and thereby nullify the basic guidance mechanism of the American system of free enterprise. Exemptions from the antitrust laws should not be granted to any industry unless there has been a convincing demonstration that competition has failed to perform its traditional function of allocation.

In 1979, the Report of the President's National Commission For the Review of Antitrust Laws and Procedures concluded (at p. 177) that exemptions from the national policy of free market competition, fostered by vigorous antitrust enforcement, should only be made when there is "compelling evidence of the unworkability of competition or a clearly paramount social purpose." The proponents of this legislation cannot make such a showing.

The proferred rationale for this bill, and indeed its name, ("Interbrand Competition Act") are based on the contention that the predominant effect of beer distribution monopolies will be pro-competitive. However, the Supreme Court in Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) has ruled that exclusive distribution arrangements only violate the antitrust laws if they can be conclusively shown to have a predominantly anti-competitive effect. A court would have to rule that the distribution monopolies destroyed intrabrand competition to a

degree which heavily outweighed any pro-competitive effect in the interbrand market. This means that the bill cannot possibly foster competition, but can only exempt from an antitrust remedy activity proven to be anti-competitive after a thorough "rule of reason" analysis. The merits aside, the so-called "Malt Beverage Interbrand Competition Act" should be rejected because its very name amounts to a fraudulent misrepresentation by implying that it would foster rather than discourage competition.

Because S. 1680 cannot possibly aid competition and can only immunize proven anti-competitive conduct, a rationale for its adoption must be found in some societal goal, superior to the goals of free enterprise. Proponents of this bill have urged three justifications, arguing that it is necessary to solve the problem of stale beer, to eliminate transshipment of the product and avoid costly antitrust litigation.

Even if the alleged problem of stale beer existed, I would suggest it is not of such paramount public concern as to override the policies of the antitrust laws which have been called the "Magna Carta" of the American system of free enterprise. Furthermore, many far more perishable food products have long been successfully distributed without establishing exclusive territorial monopolies. Less drastic means are available to protect consumers against the sale of overage beer. Foods such as milk and bread, for example, are clearly labelled with expiration dates. Beer and ale are so labelled in nations such as Great Britain.

The second justification concerning the prevention of transshipment really just restates the specious argument concerning competition. Transshipment is said to be a ruinous species of competition. It allegedly results in the business failures of franchised wholesalers, who are unable to compete effectively against the transshipper who gets a "free ride" from the franchised wholesaler's advertising and promotional expenditures.

Transshipment is justifiably regarded by the antitrust laws as merely one form of free and open competition, that results in lower retail prices and an increased number of sellers in the marketplace. Furthermore, transshipment is always instituted by the very franchised distributors who are supposed to be the victims of the practice. Under current antitrust law they are perfectly free to transship or not, and to pass on their promotional costs to whomever buys the product. Carrying the banner of the victimized distributors, the beer manufacturers have simply asked Congress to give them an anticompetitive weapon to bludgeon the distributors into complying with a scheme to create distribution monopolies.

The National Institute of Economics and Law has testified before the House Subcommittee on Monopolies and Commercial Law that "[t]here is no empirical evidence to indicate that a "free-rider" problem exists, i.e. the sales of beer by some distributors at the advertising expense of others." Moreover, as a general proposition, the antitrust laws were enacted to insure the blessings of competition to the society as a whole rather than protect one business from competition with another.

The third argument advanced in support of this bill is that it is necessary to protect the industry against protracted and costly litigation. The risk of litigation is part of the price

of doing business in America. It is a risk that can only be eliminated by depriving someone, in this case competitors and consumers, of the fundamental right to seek redress in the courts for a perceived wrong. Nor is litigation a very substantial risk to the entities that seek the protection of this legislation. Anheuser-Busch and Miller Brewing, the giant brewers who control well over half the national beer sales, were secure enough to institute territorial monopolies in 1983 in the face of current law and the risk of antitrust litigation. They are in a far better financial position than their potential adversaries to conduct protracted litigation, which can only be successful if the distribution monopolies are conclusively shown to be an unreasonable restraint of trade.

Furthermore, this bill will not even prevent litigation. Under S. 1680 exclusive territorial arrangements would be deemed lawful so long as the particular brand of beer was in "substantial and effective competition" with other brands of beer. Nowhere is this term defined in the bill and its meaning is ambiguous. This new standard's relationship to the traditional "rule of reason" standard, utilized by the courts to determine the lawfulness of exclusive territorial arrangements, is not expressed. Accordingly, rather than protect against litigation, this bill invites it.

The regrettable enactment of the Soft Drink Interbrand Competition Act of 1980 has emboldened the beer industry to seek the same type of special interest legislation. If S. 1680 succeeds, the already lengthy queue of industries seeking antitrust immunity will only grow longer. The antitrust laws have already been sapped of much vitality by restrictive decisions like the Illinois Brick case and an enforcement policy at the Federal level which vacillates between neglect and open hostility to the punishment of criminal retail price-fixers. Further erosion through exemptions like that proposed in S. 1680 will result in a patchwork of differing antitrust rules for each industry, further restricting effective antitrust enforcement. Furthermore, the business community will labor under a byzantine array of diverse and shifting standards.

This bill is also clearly inimical to the interests of the nations' beer consumers. It will ensure a more concentrated market of beer wholesalers, in an industry which each year has fewer brewers. Beer prices are kept down by intrabrand competition, that is, competition between distributors of the same brand. The beer consuming public has significant brand loyalty created in large measure by the hundreds of millions of dollars expended to create distinct brand identities. If a single wholesaler controls a particular brand, there is a strong incentive for it to charge whatever price the market will bear. Competition from other wholesalers or distributors selling the same brand acts as a lever against monopoly pricing. Moreover, even the minimal effects of interbrand competition are often rendered illusory because the same wholesaler serves as an exclusive distributor for different brands in the same area, and thus there is no motive for the distributor to compete for sales by lowering his price for any particular brand. The record of antitrust enforcement also demonstrates that in highly concentrated industries with a limited number of distributors, price collusion often occurs. All these factors caused my office to predict large price increases when Anheuser-Busch and Miller adopted distribution monopolies in 1983. Although not all the data is conclusive, the initial price surveys in New York confirm

major price increases attributable to the enforcement of territorial exclusivity.

In price surveys conducted by the New York City Department of Consumer Affairs, soft drink prices have risen 4% in the first ten months of 1983, whereas the beer prices surveyed have risen approximately 30%. Consumer Affairs used Budweiser and Miller High Life as the beer brands surveyed. In 1983 New York also adopted a soft drink and beer bottle deposit law which was expected to raise the retail prices of beer and soft drinks in roughly equivalent amounts. I draw a logical conclusion from these startling figures. The grossly disproportionate rise in beer prices is due in large part to the effects of the distribution monopolies instituted by Anheuser-Busch and Miller Brewing in 1983. The New York Times drew the same conclusion when it endorsed legislation, which my office proposed, to make territorial monopolies for beer distribution illegal.

In summing up, I will quote from a document submitted to the New York State Legislature when in 1976 it was proposed that territorial monopolies for beer distribution be mandated by law. The case against S. 1680 could not be stated more succinctly.

> "If enacted this bill would grant territorial monopolies for the sale of beer to present beer wholesalers".... The bill would restrict competition between brands. Many of the specialty, imported and marginal brands would be forced out of the New York State market. Concentration of market power would follow and, with it, higher consumer prices and reduced consumer choice.... The real objective of this bill, and of franchise protection laws in general, is special interest favoritism, granting wholesalers a perpetual hold on the distribution of products and foreclosing by legislation any competition.... The absence of any competition would inevitably precipitate a price rise."

The memorandum I quote from was submitted by the Miller Brewing Company (annexed hereto as Exhibit A). A memorandum similar in content was also submitted by the United States Brewers Association on behalf of its members which included, Anheuser-Busch, Miller Brewing and the Joseph Schlitz Brewing Company (annexed hereto as Exhibit B).

The public interest would be well served by a resounding defeat for this ill-conceived and selfishly motivated legislation.

Very truly yours,

Robert Abrams

ROBERT ABRAMS

STATE OF NEW YORK
DEPARTMENT OF LAW

ROBERT ABRAMS
Attorney General

LLOYD CONSTANTINE
Assistant Attorney General in Charge
Antitrust Bureau

TWO WORLD TRADE CENTER
NEW YORK, NY 10047

(212) 488-7555

December 2, 1983

Hon. Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Re: Malt Beverage Interbrand
Competition Act (S. 1680)

Dear Mr. Chairman:

In support of Attorney General Abrams's testimony submitted to your Committee in opposition to the above-referenced bill, enclosed please find a certified copy of the average Market Basket Soda and Beer Price Figures for New York City for the Years 1982 and 1983 as surveyed by the New York City Department of Consumer Affairs.

As the figures indicate, soft drink prices have risen approximately 4% in tne first ten months of 1983, whereas beer prices have risen approximately 30%. The brands surveyed are Coca-Cola and Budweiser or Miller. As noted in Mr. Abrams' testimony, New York adopted a soft drink and beer bottle deposit law which was expected to raise the retail prices of beer and soft drinks in roughly equivalent amounts. We conclude that the grossly disproportionate rise in beer prices is due in large part to the effects of the distribution monopolies instituted by Anheuser-Busch and Miller in 1983. The New York Times and Newsday have drawn the same conclusion when they endorsed legislation, which our office proposed, to make territorial monopolies for beer distribution illegal in New York State.

If you have any questions or need additional information, please do not hesitate to contact me.

Very truly yours,

Richard M. Weinberg

RICHARD M. WEINBERG
Assistant Attorney General

RMW:ma
Encls.

The City of New York

DEPARTMENT OF CONSUMER AFFAIRS
80 LAFAYETTE STREET, NEW YORK, NEW YORK 10013
Telephone 566- 0889

Simon P. Gourdine, *Commissioner*

November 18, 1983

Mr. Richard Weinberg
Assistant Attorney General
Two World Trade Center
Room 4579
New York, New York 10047

Dear Mr. Richard:

Confirming our telephone conversation, enclosed are the certified average Market Basket soda and beer figures for the years 1982 and 1983. The Department surveys Coca Cola and Budweiser or Miller.

Sincerely,

Connie Quigley

Connie Quigley
Researcher

CQ:jt
Enclosure

APPENDIX A

SODA AND BEER PRICES

Market Basket Week	Dates	Soda 1983	1982	Beer 1983	1982
425	12/20 - 12/31	$2.12	$2.29	$2.81	$2.66
426	01/03 - 01/14	2.28	2.23	2.79	2.62
427	01/17 - 01/28	2.27	2.26	2.83	2.74
428	01/31 - 02/11	2.29	2.26	2.80	2.73
429	02/14 - 02/25	2.31	2.24	2.83	2.75
430	02/28 - 03/11	2.32	2.28	2.81	2.75
431	03/14 - 03/25	2.24	2.26	2.81	2.76
432	03/28 - 04/08	2.20	2.26	2.70	2.77
433	04/11 - 04/22	2.28	2.21	2.76	2.81
434	04/25 - 05/06	2.25	2.14	2.84	2.67
435	05/09 - 05/20	2.27	2.21	2.84	2.63
436	05/23 - 06/03	2.19	2.16	2.82	2.58
437	06/06 - 06/17	2.06	2.19	2.86	2.68
438	06/20 - 07/01	2.05	2.13	2.79	2.66
439	07/05 - 07/15	2.05	2.16	2.79	2.73
440	07/18 - 07/29	2.08	2.17	2.56	2.77
441	08/01 - 08/12	2.05	2.13	2.85	2.79
442	08/15 - 08/26	2.13	2.15	2.81	2.79
443	08/29 - 09/09	2.12	2.17	2.86	2.80
444	09/12 - 09/23	2.30	2.16	3.37	2.82
445	09/30 - 10/07	2.28	2.12	3.31	2.82
446	10/11 - 10/21	2.20	2.16	3.45	2.78
447	10/24 - 11/04	2.21	2.17	3.50	2.79

NATIONAL CONFERENCE of STATE LIQUOR ADMINISTRATORS

THOMAS J. KENNEDY
N.C.S.L.A. President
Alcoholic Beverage Control Division
Department of Revenue
Room 521-S, State Office Building
Topeka, Kansas 66625
(913) 296-3946

DEC 11 1983

TERRANCE D. MICEK
N.C.S.L.A. Executive Secretary-Treasurer
Nebraska Liquor Control Commission
P.O. Box 95045
Statehouse Station
Lincoln, Nebraska 68509
(402) 471-25 1

December 6, 1983

Honorable Strom Thurmond
Chairman, Judiciary Committee
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing to you in my capacity as both President of the National Conference of State Liquor Administrators and Director of the Alcoholic Beverage Control Division, Department of Revenue, State of Kansas.

The National Conference of State Liquor Administrators is a non-profit organization composed of all state agencies charged with the responsibility of administering and enforcing state alcohol beverage laws and the collection of taxes related thereto.

Our primary purpose is to devise and promote the enactment of the most effective and equitable types of state liquor laws, and to employ these to enforce and make effective the particular liquor laws of each state. We regularly interchange ideas on liquor taxation and control on solving administrative problems, on promoting interstate comity in taxation, and on promoting harmony between state liquor laws and the administration of federal enactments.

In accordance with these objectives, NCSLA, at its recent annual conference, examined the merits of S.1680. The conclusion of that examination was that this bill would strengthen the hands of liquor administrators in each state in enforcing the laws of the state. A formal resolution urging the Ninety-Eighth Congress to enact the Malt Beverage Interbrand Competition Act as soon as possible was officially adopted by the members of NCSLA. A copy of that resolution is enclosed. I am writing in support of S.1680, both as it benefits the State of Kansas in its administrative control of malt beverages and as it benefits most NCSLA member states.

S.1680 holds territorial agreements between suppliers and wholesalers exempt from the antitrust provisions of the Sherman Act and the Clayton Act. In so doing, it strengthens the authority of Kansas and other states to enforce franchise agreement provisions already enacted in these states.

In Kansas, brewers and other suppliers are authorized to sell to only one distributor in a given geographic area. This concept was enacted into law in Kansas in 1982. Prior to this enactment by the Kansas Legislature, the prohibition of dual franchises between breweries and distributors for the sale of cereal malt beverage (3.2% beer) had been a trade practice in Kansas since repeal in 1937. In 1949, the Liquor Control Act was passed authorizing the sale of alcoholic liquors to include strong beer (over 3.2%). Again, the strong beer distributors and liquor wholesalers, who handle strong beer, followed the trade practice established by the cereal malt beverage distributors of not having dual franchises in a given territory. This new law passed in 1982 was part of the three-tier merchandising system established by the legislature to provide an orderly market for intoxicating liquors from manufacturer to distributor, distributor to retailer and retailer to consumer. Franchising between suppliers and distributors

is designed to promote healthy price competition between brands while providing an orderly market to protect state interests.

Colby Distributing Co. v. Lennen, [227 Kan. 179(1980) cert. denied U.S. Supreme Court] was an attack upon exclusive franchsing statutes in Kansas under the Sherman Act. The Kansas Supreme Court denied the allegation of conflict with the Act and state and federal constitutions on the ground that the system promoted interbrand competition and furthered state interests such as orderly tax collection, price regulation and brand identification within the state. These were seen as legitimate interests incidental to the unique position held by intoxicating liquor in the state's regulatory scheme, and as such the act is not violative of the strict antitrust regulations prevalent in other commercial areas.

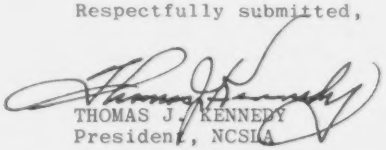
The member states of NCSLA have similar statutory interests to uphold, and the Malt Beverage Interbrand Competition Act would aid most of us in protecting these legitimate objects. Member states include Alaska, Arizona, Arkansas, California, Colorado, Connecticul, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas and Wisconsin. Your committee probably has already heard from some members and may hear from others of the licensed states constituency.

Exclusive franchise agreements can be an excellent tool to facilitate legitimate state ccntrols in the marketing of malt beverages. Where one brand is available from only one distributor in a given geographic area, it is much easier for state authorities to make inspections, to audit for tax purposes, and to enforce the laws. When a violation of a liquor law is discovered, it is much simpler to trace the violation to its source. Interbrand competition is not affected by such controls. Overall it is a good system that is in place in several states and is working well for both state authorities and malt beverage industry members.

S.1680 would also serve a useful purpose in forestalling potential legal questions about exclusive franchise agreements. The U.S. Supreme Court recently considered an antitrust challenge to in-state price controls on liquor sales [California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97, 1980]. The Court in Midcal, citing with approval an earlier decision [Hostetter v. Idelwild Liquor Corp., 337 U.S. 324, 1964] recognized the fact that conflicts can arise between the Commerce Clause and the Twenty-first Amendment. Rather than articulate specific guidelines for resolving such conflicts, the Court simply stated, "The competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a 'concrete case.'" Midcal at 110. Congress, by passing S.1680, could easily remove the question of franchise agreements from yet another "concrete case".

For all of these reasons, on behalf of NCSLA and the State of Kansas, I urge in the strongest possible way your support for the passage of S.1680, the Malt Beverage Interbrand Competition Act, and would request that this letter be made a part of the record of your deliberations on this bill.

Respectfully submitted,



THOMAS J. KENNEDY
President, NCSLA
and
Director, Alcoholic Beverage Control Division, Kansas

TJK:cjk
Enclosure

RESOLUTION NO. 8
MALT BEVERAGE INTERBAND COMPETITION ACT

WHEREAS, the National Conference of State Liquor Administrators is composed of all state agencies charged with the responsibility of administering state alcohol laws and the collection of taxes related thereto; and

WHEREAS, the purpose of the National Conference of State Liquor Administrators is to devise and promote the enactment of the most effective and equitable type of state liquor laws for all citizens; and to devise and promote the use of such methods to enforce and make effective the particular liquor laws of each state as promulgated under the authority of the 21st Amendment to the Constitution of the United States of America; and to achieve harmony between the administration of the liquor laws of the federal government and the administration of the liquor laws of the several states; and

WHEREAS, there are strong forces at work in the marketplace to break down the regulatory powers of the state liquor administrators granted by the laws of their respective states; and

WHEREAS, the Congress of the United States is currently considering the Malt Beverage Interbrand Competition Act which will greatly strengthen the ability of state liquor administrators to effectively discharge their responsibilities for controlling malt beverages as dictated by the laws of the several states, and promote more effective collection of, and interstate comity in, malt beverage excise taxes;

NOW, THEREFORE, BE IT RESOLVED that the National Conference of State Liquor Administrators strongly urges the 98th Congress of the United States to enact the Malt Beverage Interbrand Competition Act into law in a timely manner.

BE IT FURTHER RESOLVED that the voting record become a part thereof, to wit: 10 yeas, 9 nays, 1 present and not voting, and 4 not present.

State of New Jersey
DEPARTMENT OF LAW AND PUBLIC SAFETY
DIVISION OF ALCOHOLIC BEVERAGE CONTROL

THOMAS H. KEAN
GOVERNOR

OFFICE OF THE DIRECTOR
Richard J. Hughes Justice Complex
CN 087
Trenton, NJ 08625
(609) 984-3230

IRWIN I. KIMMELMAN
ATTORNEY GENERAL

JOHN F. VASSALLO, JR.
DIRECTOR

December 8, 1983

The Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

Thank you very much for your letter of November 14, 1983 regarding S.1680, the "Malt Beverage Interbrand Competition Act." I very much appreciate the fact that you replied to my prior letter of November 2, 1983.

In my prior letter I indicated that I had not yet finished my opinion on the hearings that I had held regarding New Jersey's regulations on transshipping. I have now completed that opinion, and I am herewith enclosing two copies of it.

You may feel free to include the opinion as part of the record of the Committee on the Judiciary's hearings on the proposed act. Also, I would be very glad, and even privileged, to testify before the Committee at such time as further hearings are held.

Best wishes for a very happy holiday season.

Sincerely yours,

JOHN F. VASSALLO, JR.
DIRECTOR

JFV:lg

New Jersey Is An Equal Opportunity Employer

STATE OF NEW JERSEY
DEPARTMENT OF LAW AND PUBLIC SAFETY
DIVISION OF ALCOHOLIC BEVERAGE CONTROL

In the Matters of:	
TODD SEIFERT, t/a SEIFERT DISTRIBUTING COMPANY, and ANTHONY ESPOSITO, t/a LONGWOOD DISTRIBUTORS,	FINDINGS AND CONCLUSIONS CONFIRMING VALIDITY OF REGULATIONS, N.J.A.C. 13:2-25.2(a), 13:2-25.3(b) and 13:2-33.1
and	
CLAUDIO IODICE, t/a INTERNATIONAL BEVERAGE DISTRIBUTOR,	
FOR A REVIEW AND HEARING CONCERNING N.J.A.C. 13:2-25.2(a), 13:2-25.3(b), and 13:2-33.1.	

Christine H. Steinberg, Deputy Attorney General on behalf of the Division of Alcoholic Beverage Control (Michael R. Cole, Acting Attorney General, attorney).

John J. Byrne, III, on behalf of Todd Seifert, t/a Seifert Distributing Company, and Anthony Esposito, t/a Longwood Distributors (Cole, Geaney, Yamner & Byrne, attorneys)

John A. Herfort, on behalf of Claudio Iodice, t/a International Beverage Distributor. (Gelberg & Abrams, of New York, N.Y., attorneys).

Edward G. D'Alessandro and Brian E. Mahoney, on behalf of the Beer Wholesalers' Association of New Jersey (D'Alessandro, Sussman, Jacovino & Mahoney, attorneys).

David Samson and Douglas P. Black, on behalf of the New Jersey Wine and Spirit Wholesalers Association (Wolff & Samson, attorneys).

Gary M. Nateman, on behalf of the United Brewers Association, Inc. (Gary M. Nateman, of Washington, D.C., general counsel).

Russell W. Shannon, on behalf of the Distilled Spirits Council of the United States, Inc. (Russell W. Shannon, of Washington, D.C., general counsel).

Peter E. Moll and John Conkle, on behalf of Anheuser-Busch Companies (Howrey & Simon, of Washington, D.C., attorneys; David C. Welsch, of St. Louis, Mo., of counsel).

Bruce L. Montgomery, Thomas H. Milch, and Edward L. Wolf, on behalf of Miller Brewing Company (Arnold & Porter, of Washington, D.C., attorneys).

Ralph J. Savarese, Ray A. Jacobsen, Jr., and Paul A. Koches, on behalf of Heublein, Inc., (Howrey & Simon, of Washington, D.C., attorneys).

Barry R. Temkin, on behalf of Wine and Spirit Retailers of New Jersey (Hellring, Lindeman, Goldstein & Siegal, attorneys).

William B. Schreiber and Michael T. Kelly, on behalf of Joseph E. Seagram & Sons, Inc., (Schreiber & MacKnight, of New York, N.Y., attorneys).

BY THE DIRECTOR:

On June 1, 1983, and July 6, 7, 8, 11, 12, 13, 14, 1983, extensive informational hearings[1] were held by the Director as to N.J.A.C. 13:2-25.2(a), 13:2-25.3(b) and 13:2-33.1, which were adopted in 1979, and which provide:

"Subchapter 25. Diversion, Transshipment and Registered Distribution

* * *

13:2-25.2 Registered Distribution

(a) No plenary wholesale, wine wholesale or limited wholesale licensee shall sell, deliver, or include in its Current Price List any brand of alcoholic beverages not acquired from the owner of the brand or its registered supplier pursuant to N.J.A.C. 13:2-33, or for which that wholesaler or distributor is not a registered wholesaler or distributor pursuant to N.J.A.C. 13:2-33, except pursuant to waiver provisions of N.J.A.C. 13:2-33.1(b)3, when granted permission by the Director upon petition setting forth the brand name, the quantity to be acquired, the source of supply, and such other information as the Director may deem necessary.

* * *

13:2-25.3 State Beverage Distributors

* * *

(b) No State Beverage Distributor shall sell, deliver, acquire, or purchase or include in its Current Price List malt alcoholic beverages not acquired or purchased from the owner of the brand or its registered distributors pursuant to N.J.A.C. 13:2-33, except pursuant to waiver provisions of N.J.A.C. 13:2-33.1(b)3, when granted permission by the Director upon petition setting forth the brand name, the quantity to be acquired, the source of supply, and such other information as the Director may deem necessary.

---

[1] Notice of the hearings was given by the Director to all parties known or thought to have an interest, and it was published in its entirety in the May 23, 1983, Beverage Retailer Weekly, a New Jersey alcoholic beverage industry trade publication. The Director also discussed the hearings with a reporter of the Newark Star Ledger, which carried articles about the hearings and thereby gave further notice of them. There was ample opportunity for any interested party to be heard, and in fact twenty-nine witnesses testified and 63 exhibits were submitted for the record. Parties were permitted to submit clarifying questions through the Director, and to directly question the expert witnesses.

"Subchapter 33. Product Information Filing: Brand Registration

13:2-33.1 Schedule of product filing

(a) No licensee shall sell or offer for sale or deliver, or receive or purchase at wholesale or retail, any alcoholic beverage, including private label brands owned by a retailer and exclusive brands owned by a manufacturer or wholesaler and offered for sale or sold by such manufacturer or wholesaler exclusively to one New Jersey retailer, unless there is first filed with the Director of the Division of Alcoholic Beverage Control for each calendar year a schedule listing the following:

1. Its correct brand or trade name;
2. Its nature and type;
3. Its age and proof of alcoholic content when stated on the label;
4. The standard number of unit containers per standard case;
5. The capacity of each unit container; and
6. The names of all New Jersey licensees acknowledged by the filer to be an authorized distributor of the product at wholesale.

(b) The schedule shall be filed by:
1. The manufacturer or wholesaler who owns such brand; or
2. A wholesaler selling such brand who is appointed as exclusive agent by the brand owner for the purpose of filing such schedule; or
3. Any wholesaler with the approval of the director in the event that the owner of such brand does not file or is unable to file a schedule or designate an agent for such purposes; or
4. In the case of private label brands, by the manufacturer or wholesaler supplying such private label brand to the retailer or by any wholesaler having authority, in writing, from the retailer owning such private label brand, except where the alcoholic beverages are imported by the retailer under a special permit issued by the director, in which case the retailer shall file the schedule and the labels."

The hearings were the result of a remand order issued by Part B of the Appellate Division on October 18, 1982, in Todd Seifert, t/a Seifert Distributing Company[2] and Anthony Esposito, t/a Longwood Distributing Company[3] and Anthony Esposito, t/a Longwood Distributors vs. John F. Vassallo, Jr., Director of the Division of Alcoholic

---

[2]Todd Seifert, t/a Seifert Distributing Company, who holds a State Beverage Distributor license, (which type license permits sales to be made to consumers at retail, with some exception, as well as wholesale sales), has been a designated distributor of Ballantine and Utica Club since 1933. In 1978, Todd Seifert began transshipping other brands, for which he is not a registered distributor. The transshipped brands now constitute about 85% of his business.

[3]Anthony Esposito, t/a Longwood Distributors, is also a State Beverage Distributor licensee and has been in business for about 27 years.

(Continued)

Beverage Control of the State of New Jersey, Docket No. A-345-82T3, wherein the Court said:

> "Appellants' motion for a stay of the application of N.J.A.C. 13:2-25.3(b) as to Seifert Distributing Co. and Longwood Distributors pending appeal is granted.
>
> "We have serious doubt that the regulation in question serves any valid public purpose, and it may be unreasonable. The regulation had been stayed by the Director, Division of Alcoholic Beverage Control, from June 2, 1980 until August 10, 1982, when the decision in this matter was rendered based upon evidence presented at a hearing held on July 10, 1980. In these circumstances, we sua sponte order the matter remanded to the Director, Division of Alcoholic Beverage Control, for a hearing to determine whether the regulation serves a valid public purpose or is unreasonable. On such remand evidence may be offered of the impact, if any, of the stay of the regulation beginning on June 2, 1980 upon the goals purportedly served by the regulation. Such other evidence of the impact of the regulation may be considered as the parties may present.
>
> "The proceedings on this appeal shall be suspended pending completion of the proceedings on remand. Following completion of the remand, appellants may file an amended notice of appeal or may withdraw their appeal in the event the determination on the remand is favorable to their position. Should the appeal be continued, the schedule for filing appellants' brief and appendix shall be determined in relation to the time of filing an amended notice of appeal."

A second Appellate Division matter, Claudio Iodice t/a International Beverage Distributor[4] vs. John F. Vassallo, Jr., Director of the Division of Alcoholic Beverage Control of the State of New Jersey, Docket No. A-5420-81 T3, was consolidated for the purposes of the hearings as the result of a May 6, 1983, order by Part F of the Appellate Division, wherein the Court granted Claudio Iodice t/a International Beverage Distributor's "motion for temporary remand and stay of the application of N.J.A.C. 13:2-25.3(b) (sic) pending appeal ... pursuant to the same conditions incorporated in the order of Judge Botter

---

(Footnote 3 continued)
About 1974 he was subcontracted by Warren Distributors, an authorized Genesee distributor, to distribute the brand in Morris and Sussex Counties. He did this until 1977, when Warren took over those two counties itself. Esposito then turned to transshipping. In 1979, he sold the business to John Roe, but took it back in 1980 after default by Mr. Roe. Longwood is an authorized distributor of a number of small, primarily imported brands.

[4]Claudio Iodice, t/a International Beverage Distributor, first applied for and was issued a limited wholesale license in May of 1982. He is a designated distributor for Pearl Beer and transships the balance of the alcoholic beverages he has been distributing.

dated October 18, 1982, in the matter of Seifert Distributing Company and Longwood Distributors," supra. That order referred to N.J.A.C. 13:2-25.3(b) but should have referred to N.J.A.C. 13:2-25.2(a) as Claudio Iodice holds a limited wholesale license rather than the state beverage distributor license held by both Todd Seifert and Anthony Esposito. The effect of both sections, which will be dealt with in detail, is substantially similar, and both can be collectively considered New Jersey's "Primary Source" regulations.

Although the Appellate Division's orders did not mention it, N.J.A.C. 13:2-25.2(a) and 13:2-25.3(b) cannot be considered without also considering the "Brand Designation" or "Brand Registration" regulation, N.J.A.C. 13:2-33.1. Consequently, the Director gave notice, on May 9, 1983, that the hearings to commence on June 1, 1983, would encompass all of the aforementioned regulations. The Director additionally announced that the hearings would also serve the purpose of evaluating the said regulations pursuant to Executive Order 66 (1978), which would cause them to expire on April 12, 1984, unless re-adopted.

This was not the first hearing concerning the brand registration and primary source regulations in question. Prior to their adoption in April, 1979 hearings were held by former Attorney General John J. Degnan and former Director Joseph H. Lerner and their staffs on February 8 and 9, 1979. Those hearings were to consider the adoption of the "deregulation" package of regulations, of which the brand registration and primary source regulations were a part. Following those hearings and the adoption of the regulations, Todd Seifert t/a Todd Seifert Distributors Co. and Longwood Distributors, Inc. petitioned the Division for a review of the primary source regulations and to have them stayed as to them. Former Director Lerner held hearings on July 10, 1980, but no decision was rendered by him, apparently due to the pendency before the United States Supreme Court of an appeal from a California Court of Appeal decision, Norman Williams Company v. Baxter Rice, 108 Cal. App. 3d 348, 166 Cal. Rptr. 563 (1980), which had ruled

that a California statute,[5] identical in effect to the New Jersey primary source regulations, was unlawful under the Sherman Antitrust Act and thus preempted under the Supremacy Clause of the Constitution of the United States.

It was after the reversal of that California decision by the United States Supreme Court in July, 1982, [see, Rice v. Norman Williams Co., ____U.S.____, 102 S. Ct. 3294, 73 L Ed 2d 1042, 50 U.S. L.W. 5052 (6-29-82) (1982)] that I, following a review of the record and transcripts of the prior hearings, upheld the validity of the brand designation and primary source regulations and vacated the stays of enforcement as to the petitioners in those proceedings. In the Matter of the Petitions of Todd Seifert, t/a Seifert Distributing Co. and Longwood Distributors, Inc. for a Review and Hearing Concerning N.J.A.C. 13:2-25.3(b), A.B.C. Bulletin 2428, Item 3 (August 10, 1982). In that Order Vacating Stay of Enforcement, entered on August 10, 1982, the public purposes served by these regulations were noted:

> "After reviewing the transcripts and written summations of counsel, the Supreme Court's decision in Rice v. Williams, supra, and my responsibilities as Director under Title 33, it is my determination that the public interest is and will continue to be best served by the brand registration regulations.
>
> "An important responsibility of any Director of the ABC is to ensure that all taxes on sales of alcoholic beverages are properly paid, and that all licensees responsible for the payment of those taxes are easily identified. N.J.S.A. 33:1-39 specifically empowers the Director to make regulations regarding taxes and their enforcement. The two regulations under consideration substantially aid in identifying licensees subject to taxation through the filing of reliable and verifiable documentation. The State Supreme Court recognized the validity of this in Heir v. Degnan, 89 N.J. 109, 125 (1980), when it upheld a challenge to N.J.A.C. 13:2-25.1.
>
> "The regulations under consideration also serve at least two other purposes. First, they provide a certain degree of stability within the market and in the economic structure of the industry within the State. Brewers can rely upon distributors selected by and answerable to them. Designated distributors can provide a higher level of service to retailers, including point of sale marketing aids. Designated distributors need not fear attempts by undesignated

---

[5] California Business and Professions Code Section 23672 provides that a "licensed importer shall not purchase or accept delivery of any brand of distilled spirits unless he is designated as an authorized importer of such brand by the brand owner or his authorized agent."

distributors to take a free-ride on their marketing efforts. Retailers are benefitted by reliable service from designated distributors and are able to complain directly to the brewer if service is lacking. A retailer which deals with undesignated distributors may not have an effective source to which to make complaints because the brewer has no control over undesignated wholesalers. Consumers of this State are protected as to availability of product, proper channels for complaints and assured (sic) collecting tax revenues. Coupled with these benefits to the various segments of the industry and to consumers are the stability and security which the regulations provide to the economic investments of the designated wholesalers and their employees in this State. Undesignated wholesalers can wreck havoc on distribution and supply planning and on the quantum of employment and man-hours required to make such distribution and provide such service, thereby creating job insecurity and unemployment. Trade stability has always been recognized as important in the regulation of alcoholic beverages in this State. Heir v. Degnan, supra, at 114 and Grand Union Co. v. Sills, 43 N.J. 390 (1964). It continues to be important today, and is a very important consideration herein.

"A second purpose served by the regulations is quality control. The testimony by Mr. Garrity, Mr. Tripuka and Mr. Lonergan indicates that the 'life' of beer is fairly short and that it must be properly warehoused and checked before sale. The consumers of the State have a right to expect beer being purchased to be at its peak in flavor and quality. Both petitioners testified that there is no problem with the quality of the beer which they sell. But neither petitioner is supervised by the brewers whose beers are sold, and neither has any contractual responsibilities to those brewers. Under these circumstances, it is not unreasonable to expect that beer, which has been purchased outside the brewers' established distribution network, may be less fresh and/or less well cared for than beer sold by designated distributors.

"Although I do not consider the quality control issue to be the primary reason for enforcing the regulations, it does merit consideration. Enforcement of the regulations should insure that outdated or stale beer is not offered to the consuming public."

Notwithstanding the conclusions of the Director, upon appeal of the Order Vacating Stay of Enforcement, supra, by petitioners Seifert and Esposito, the Appellate Division remanded for further hearings as discussed above. In compliance with the remand order, I held the June and July, 1983, hearings.

Upon consideration of the entire record of the June and July, 1983, hearings, which were very extensive, as well as the records and transcripts of the prior proceedings and hearings of February 8 and 9, 1979, and July 10, 1980, supra, and substantial portions of the record of proceedings on the Malt Beverage Interbrand Competition Act (S. 1215 and H.R. 3269) before the Committee

on the Judiciary of the United States Senate and the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary of the House of Representatives, held in the Second Session (1982) of the Ninety-Seventh Congress, and having also carefully considered the arguments advanced by a number of counsel in very well written and extensively documented briefs and memoranda, I cannot but continue to conclude, as I did in the order of August 10, 1982, supra, that the Brand Designation and Primary Source Regulations, N.J.A.C. 13:2-33.1, and 13:2-25.2(a) and 25.3(b), are valid, reasonable and necessary to protect the goals of alcoholic beverage control and that the public interest is and will continue to be best served by the continuation of these regulations; and they should be re-adopted upon expiration pursuant to executive Order 66, (1978) in April, 1984. The interests of the State of New Jersey and its residents in a stable alcoholic beverage industry, capable of being controlled and monitored, significantly outweigh any particular limited interests of the petitioners. Those findings and conclusions as enunciated by me in the prior Order were confirmed and strengthened by the evidence produced at the July, 1983 hearings. If I had any previous doubt as to the wisdom of my predecessor in adopting the Brand Registration and Primary Source Regulations, I do not now. There is no doubt whatsoever that these regulations are valid and reasonable and serve a valid public purpose, as will be explained in greater detail.

Although the petitioners have suggested that, because of the remand, the primary source regulations do not carry the usual presumption of validity, I do not agree. I see the remand as a question raised by the Appellate Division without benefit of a full record and based on a question as to whether there could be any validity to a regulation that has had its effectiveness stayed for a period of three years. The Court was merely questioning the necessity for the regulations if a long period could pass without the enforcement of the regulations. In that limited context of the stay granted to the petitioners, it is a fair question.

To answer that question raised by the Appellate Division as to

"the impact, if any, of the stay of the regulation beginning on June 2, 1980 upon the goals purportedly served by the regulation," it is necessary to note that the primary source regulations were only stayed as to the petitioners, Seifert and Longwood, since 1980. A third distributor, Jaybee Supply Corporation, which has since ceased active operation of its limited wholesale license, was granted a stay in June, 1981.[6] Finally, as noted above, Claudio Iodice was granted a stay in May of 1983. None of the approximately 270 other distributors or wholesalers, other than those four, had or even requested a stay of the enforcement of the primary source regulations. Therefore, the impact of the stay on the goals and objectives of the primary source regulations was minimal, although there was ample evidence produced at the hearings that there has been some, even if not significant, adverse effect on the stability of the industry, as a result of the stays granted to the petitioners. The primary source regulations have been in effect as to all other wholesalers and distributors, and they have generally accomplished their purposes. To eliminate the regulations would literally open a Pandora's box and would unquestionably create a chaotic and unstable distribution system, complete with the problems the primary source regulations are designed to prevent.

Thus the fact of the remand or the fact of the stay of the primary source regulations as to two, or even as to the four distributors can in no way be suggestive that the regulations are not valid. As the Supreme Court noted in Heir v. Degnan, 82 N.J. 109 (1980), at 122:

> "...Deference must be given to the Director's expertise in this field and regulations duly adopted by him are to be accorded a presumption of validity. New Jersey Guild of Hearing Aid Dispensers v. Long [75 N.J. 544 (1978)], 75 N.J. at 560-562. That presumption is overcome only when it is shown that the regulation is clearly unreasonable and has no rational relationship to the purpose intended. Consolidated Coal Co. v. Kandle, [105 N.J. Super. 104 (App. Div. 1969), aff'd o.b. 54 N.J. 11 (1969)], 105 N.J. Super. at 117."

No question has been raised that the Director lacked the statutory authority to adopt the brand designation and primary

---

[6] Appellate Division Docket No. 4343-80T3.

source regulations nor that they were not lawfully adopted in accordance with proper administrative procedure. It is not necessary to go into those matters, especially since, as will be seen later, there is a very broad power delegated to the Director by legislative fiat and the regulations were certainly proper exercises of that power. Also, the issue was disposed of in Heir v. Degnan, supra., at 82 N.J. 118-119.

It is therefore clear that the sole question regarding the regulations can be whether the regulations have a rational relationship to the purpose intended. It is not whether, as petitioners have suggested, there might be another way to accomplish those same goals. The administrative action, as taken, has a presumption of reasonableness. "As was said in Pacific States [Box and Basket Co. v. White, 296 U.S. 176, 56 S.Ct. 159, 80 L.Ed. 138, 101 A.L.R. 853 (1935)], quoting from Borden's Farm Products Co., Inc. v. Baldwin, 293 U.S. 194, 209, 55 S.Ct. 187, 79 L.Ed. 281 (1934), when legislative action taken by an administrative agency is called into question, 'if any state of facts reasonably can be conceived that would sustain it, there is a presumption of the existence of that state of facts***.' Those who oppose it 'must carry the burden of showing by a resort to common knowledge or other matters which may be judicially noticed, or to other legitimate proof, that the action is arbitrary.'" Consolidated Coal Co., et al. v. Kandle, et al., supra., 105 N.J. Super. at 118-119. In dealing with the primary source and brand designation regulations, the evidence shows not just "any state of facts" that can reasonably be conceived to sustain it, but several. Any one is enough for a valid regulation. The validity of a regulation, however, also depends on its being consistent with the policy of the underlying legislation. In the Matter of the Schedule of Rates for Barnert Memorial Hospital, 92 N.J. 31, 39 (1983); New Jersey Guild of Hearing Aid Dispensers v. Long, supra, at 75 N.J. 562. Therefore, to see that the brand registration and primary source regulations are consistent with the policy of the legislative enactments and are within the authority given to the Director, a review of the legislative and administrative history of alcoholic beverage control in general and of these regulations in particular is helpful.

Grand Union v. Sills, 43 N.J. 390, 398-402 (1964), sets out a very good and succinct outline of the regulation of the sale of alcoholic beverages and it is worth repeating here:

> "Because of its inherent evils, liquor has always been dealt with as a subject apart. (Citations omitted). Its sale may be prohibited entirely or permitted under severe restrictions. (Citations omitted.) In colonial days there were laws licensing and restricting the sale of liquor, and, after the revolution, there were comparable enactments which, though revised from time to time, always gave clear recognition to the dangers and the need for controls. (Citations omitted).
>
> "Despite the licensing restrictions, abuses in the liquor industry prevailed during the nineteenth century and early twentieth century, and gave rise to much public concern. The tied house system (citation omitted) contributed to sales stimulations which ran counter to the goal of temperance, and relations between liquor and legislative interests were oftentimes unholy in nature. In 1844 the territorial legislature of Oregon adopted a prohibition law and its action was followed by similar enactments in many states, not, however, including New Jersey. In 1919 a national policy of prohibition became effective through the adoption of the eighteenth amendment and sales of alcoholic beverages became unlawful in our State as well as elsewhere. The unfortunate experiences of the prohibition era need not be recounted here; suffice it to note that in 1933 the national policy was terminated through the adoption of the twenty-first amendment. Control was returned to the states which immediately set about to establish their own systems. Seventeen states adopted some form of public monopoly. (Citation omitted). This had the high virtue of eliminating sales stimulations but it involved the displacement of private operation by public operation. The New Jersey Legislature chose to retain private operation while surrounding it with comprehensive safeguards designed to promote temperance and to eliminate the racketeer and bootlegger and other abusive incidents of the liquor traffic. L. 1933, c. 436; N.J.S.A. 33:1-1 et seq.; N.J.S.A. 33:1-3; N.J.S.A. 33:1-39.
>
> "New Jersey's Control Act ... broadly authorized the Commissioner to adopt regulations dealing with practices unduly designed to increase consumption and with such other matters as might become necessary in the stringent administration of the law. N.J.S.A. 33:1-39. In Franklin Stores Co. v. Burnett, 120 N.J.L. 596, 598 (Sup. Ct. 1938), this regulatory power was upheld in an opinion which reaffirmed the State's 'practically limitless' power to regulate the liquor industry. See Blanck v. Mayor and Borough Council of Magnolia, 38 N.J. 484, 490-491 (1962)....
>
> "In the years following New Jersey's adoption of its Control Act there were many amendments which had a common thread. They were designed to aid in the stabilization of the industry and in the promotion of temperance through the curbing of competitive practices which tended to stimulate sales. In 1938 the Legislature authorized the Commissioner to prohibit or regulate the sale of alcoholic beverages in violation of fair trade contracts (L. 1938, c. 208; N.J.S.A. 33:1-23.1); the preamble to the statute noted that

> indiscriminate price cutting and excessive advertising of cut prices were 'detrimental to the proper operation of the liquor industry and contrary to the interests of temperance.' In Gaine v. Burnett, 122 N.J.L. 39 (Sup. Ct.), aff'd. 123 N.J.L. 317 (E. & A. 1939), the court held that even without this specific legislation the Commissioner had power to fix liquor prices and promulgate price regulations; in the course of its opinion it pointed out that the fixing of liquor prices was 'an ancient method to prevent abuse in the use of a commodity of much social disadvantage.' 122 N.J.L. at p. 43. (Citation omitted).
>
> "In 1939 the Legislature prohibited discriminatory grants of discounts to liquor retailers and authorized the Commissioner to adopt regulations dealing with maximum discounts and related matters; the statutory preamble set forth that grants of discounts to selected retailers had contributed to destructive price wars which had unduly increased the consumption of alcoholic beverages and were 'detrimental to the proper operation of the liquor industry and contrary to the interests of temperance.' L. 1939, c. 87; N.J.S.A. 33:1-89; Duff v. Trenton Beverage Co., 4 N.J. 595, 602-604 (1950). In 1942 the Legislature prohibited discrimination in liquor sales to wholesalers by distillers, importers and rectifiers. L. 1942, c. 264; N.J.S.A. 33:1-93.1...."

Grand Union Co. v. Sills, supra, specifically dealt with the statute limiting beneficial interest in retail liquor licenses to two (N.J.S.A. 33:1-12.31, et seq.), but the reasoning of the Court is equally applicable here. In speaking of that statute, the Court went on to say, at 43 N.J. 403-404:

> "In any event, we do not sit here as a superlegislature nor do we concern ourselves with the wisdom of Chapter 152. Our function is to determine whether the Legislature has gone beyond the outer limits of its constitutional power. Even when dealing with an essential commodity, the Legislature is said to have broad power to adopt trade prohibitions and regulations deemed necessary for the protection of the public health, safety, morals or general welfare (citations omitted); and as has already been pointed out, when dealing with a nonessential and inherently dangerous commodity such as liquor, its power is said to be almost without limit. (Citations omitted)."

Consonant with the broad authority spoken of in Grand Union Co. v. Sills, supra, about 1950 a primary source regulation was promulgated as to alcoholic beverages other than malt alcoholic beverages. Under that regulation (former A.B.C. Regulation 34), wholesalers were permitted to purchase only from the owner of the brand or its authorized supplier, or from another wholesaler authorized by the supplier to distribute that brand. That regulation continued in effect since its promulgation and has now been continued in the current brand registration and primary source regulations under consideration in this matter.

The current brand designation and primary source regulations have their more immediate origin in the investigation of the alcoholic beverage industry commenced by the Office of the Attorney General in November, 1976. The purpose of that investigation was:

> "(1) to determine whether there are violations of existing rules and regulations that require the administrative attention of the Division of Alcoholic Beverage Control; and
>
> "(2) to determine whether existing statutes and regulations should be amended or supplemented in any respect to improve control over trade practice of the industry...." (Report of Division of Criminal Justice Antitrust Task Force to Study the Alcoholic Beverage Industry, Page I).

Alfred J. Luciani, who headed that Task Force for the Office of the Attorney General, indicated in his testimony at the July, 1983 hearings that a major problem encountered in the investigation was the lack of information that existed in 1977 and 1978 at the Division of Alcoholic Beverage Control, especially as to who was actually engaged in the alcoholic beverage industry. Because of that, the Task Force judged it necessary to create a mechanism whereby brand owners and their channels of distribution could be identified. (See also, Task Force Report, page 6). Among the specific recommendations of the Task Force was "the introduction of formal brand and distributorship registration by suppliers to replace the present practice of merely adopting Federal label filings." (Task Force Report, page 70).

It must be noted that although the Task Force spoke only of "brand and distributorship registration," that term of necessity includes the primary source regulations for without them brand registration alone is meaningless.

Following release of the Task Force report, the informational public hearings referred to earlier were held on February 8 and 9, 1979. Thereafter, proposed amendments, which included the brand registration and primary source regulations under consideration, were prepared and the notice of intention to adopt was published on June 7, 1979 at 11 N.J.R. 285 following the applicable provisions of the Administrative Procedure Act, N.J.S.A. 52:14B-4. Following the comment period and a modification of the proposal to permit non-registered distributors to sell products acquired from designated or registered wholesalers, the regulations were so

adopted and ultimately became effective February 11, 1980. The brand registration and primary source regulations were codified as N.J.A.C. 13:2-33.1 et seq., 13:2-25.2(a) and 13:2-25.3(b) respectively, and they are still in effect today. Of course, they are the subject of these proceedings.

Although the regulations[7] promulgated as a result of the Task Force recommendations, of which regulations the brand registration and primary source regulations are a part, were to be effective earlier, the effective date was delayed due to two suits filed by liquor retailers and wholesale solicitors to challenge the package of regulations. See Heir v. Degnan, supra. When the Supreme Court entered its decisions on February 11, 1980, affirming most of the regulations, including the brand registration and primary source regulations as being properly adopted (Heir v. Degnan, supra, at 82 N.J. 118-119) and within the statutory and inherent power of the Director to adopt, the regulations became effective.

In specifically speaking of N.J.A.C. 13:2-25.1, the Court, in Heir v. Degnan, supra, at 82 N.J. 125, said:

> "The regulation implements the statute and serves the valid purpose of preventing the diversion of alcoholic beverages and assuring the proper collection of taxes under the Alcoholic Beverage Tax Law, N.J.S.A. 54:43.1. The argument that both the new and the old regulations are anti-competitive and therefore invalid fails to consider the purpose for the statute and regulations, supra, and the benefit to the State resulting therefrom."

This same language can aptly be applied to the primary source regulations, which are companion to and part of the ones addressed by the Supreme Court.

As I said in the August 10, 1982, Order Vacating Stay of Enforcement, supra, and as was confirmed by the testimony of Division of Taxation Director John R. Baldwin, in the June-July, 1983, hearings, the regulations under consideration substantially aid in identifying licensees subject to taxation through the filing of reliable and verifiable documentation. The "audit trail" which the brand registration and

---

[7] "These regulations eliminate retail price maintenance in the alcoholic beverage industry except for sales below cost and otherwise modify significantly the previous policy of the ABC regarding price controls and competition." Heir v. Degnan, supra, at 82 N.J. 113.

primary source regulations establish is an indispensable element in the tax collection and tax enforcement of the very substantial taxes ($136 million in 1982) paid by the New Jersey alcoholic beverage industry. The regulations afford the means for a higher level of tax enforcement than in other industries, and with a minimum of collection problems, because of the enhanced audit capability. Where transshipping occurs, there is a greater likelihood of tax evasion since the only means of verifying sources of supply to a wholesaler (the basis for the excise or gallonage tax-see N.J.S.A. 54:41-1 et seq.) is what is reported by the transhipping distributor. If such distributor does not wish to pay all taxes, or engages in cash or invoiceless purchases to avoid records and to be able to minimize prices by excluding taxes, he would simply not report those purchases, and tax auditors would have no means of verifying them, except for the off-hand, slim chance of catching such a recordless shipment in progress. The regulations have protected the tax collections and provided an orderliness which is virtually without precedent. To do otherwise than maintain this effective tax tool would not be in the best interests of the State of New Jersey.

Similarly, the very tax base generated by the alcoholic beverage industry must also be considered. The orderliness created by the regulations also serves to protect those revenues. Without the regulations, the sources of the substantial funds can be undermined to the detriment of the State. We would be remiss to let this happen, and in fact it would constitute a dereliction of the duties of the Director which require him to "make, or cause to be made, such investigations as he...shall deem proper in the administration of this chapter and of any and all other laws now or which may hereafter be in force and effect concerning alcoholic beverages, or the manufacture, distribution or sale thereof, or the collection of taxes thereon...." N.J.S.A. 33:1-35. The brand designation and primary source regulations enhance these "investigations."

Based on the language of the Court in Consolidated Coal Co., et al. v. Kandle, et al., supra, the tax enhancement goal of the regulations is sufficient to sustain them. There are, however,

several other positive results of the regulations, many of which are also worthy of consideration or at least mention. Several of them would also each be sufficient rationale on which to base the regulations. Taken in totality, they unquestionably support their validity.

A second major effect or impact of the brand registration and primary source regulations is providing a strong degree of stability within the marketplace and also in the structure of the alcoholic beverage industry within New Jersey. This not only is in keeping with the fundamental purpose of alcoholic beverage control in this State, which is to insure a stable industry (Heir v. Degnan supra, 82 N.J. at 128; Affiliated Distillers Brands Corp. v. Sills, 56 N.J. 251, 260 (1970); Grand Union Co. v. Sills, 43 N.J. at 404), but is also in the best interests of the consuming public, protecting both availability and price, while at the same time assuring consistency with the sensitive social aspect surrounding alcoholic beverages.

A three-tier (manufacturer, wholesaler, retailer) distribution system is essential to maintenance of the restrictive control scheme established in this State. One of the prime features of it is its assuring widespread distribution and availability of product. Small distillers, vintners and brewers, as well as larger ones, can depend on designated wholesalers to service their products in accordance with their requirements and to distribute them to large and small, profitable and not-so-profitable retail accounts as well, without fear of other unauthorized distributors utilizing their efforts and usurping the more profitable accounts, which is exactly what the evidence points to as happening with transshipping. Without this protection afforded by the brand registration and primary source regulations, there is no incentive for new suppliers to enter the market, thereby depriving consumers of new products or as large a selection as is now available. Similarly, there is also an adverse effect on the marketing efforts and effectiveness of smaller suppliers, thereby further diminishing the widespread availability of brands. Transshippers' interests lie in selling primarily to the larger, more lucrative retail accounts

and at the same time selling only the more popular products and packages, rather than a full line of products, so that the economic viability of designated wholesalers who must by contract service all accounts large and small, and do so with a full and complete product line, is frustrated by their actions.

It is noteworthy that all the petitioners in these proceedings are designated distributors for one or more smaller brands. Yet a review of their filed Current Price Lists, as well as the testimony at the hearings, shows a pattern of their placing emphasis on the transshipping and sale of major brands and popular packages for which they are not authorized. This must of necessity also be detrimental to their authorized brands.

Manufacturers of alcoholic beverages, and particularly brewers, rely substantially on their designated distributors to promote and advertise their products and to primarily maintain the products' quality and integrity. Malt alcoholic beverages, wines and some liqueurs are essentially food products and require proper handling for maximum quality. Manufacturers are understandably insistent in requiring rigid standards for handling, storing and marketing their products. Climate controlled warehouses, refrigeration, proper and suitable delivery equipment and appropriate training of personnel are among the primary requirements. Although protection of the quality and freshness of the product is primarily for the economic benefit of the brand owner, it is not without benefit to the consumer. Better for him to have the assurance of a quality product as a result of the regulatory system permitting it than to acquire a product that has not been handled to standards. In such a situation, which can occur through transshipping, to where can the consumer go to complain?

Because of the quality and integrity requirements placed on the distributors, as well as the expectations that the designated wholesalers will assist in the advertising and development of the product line, the designated distributors must and have made large capital investments, and maintenance of these investments provides employment security and economic benefit to the State, as well as to the tax structure previously considered. The brand registration and primary source regulations protect

this. Transshippers and undesignated wholesalers raise havoc with it by taking unfair advantage of, or a "free-ride" on, the expenditures made by the designated distributors of a product. If such is permitted to occur, there will be no incentive for such expenditures and capital investment to be made. The number of wholesalers will diminish, and the entire structure of a now-stable industry will suffer. At the same time, there is little evidence, other than speculation, that prices would even be more favorable at the consumer level. The evidence, when carefully analyzed, even suggests the contrary.

Another benefit accruing to the State as a result of the brand registration and primary source regulations is that they solved the problem of knowing who the alcoholic beverage industry members are. The importance of this becomes apparent when the statutory mandates of Title 33, Intoxicating Liquors, of the Revised Statutes[8] are considered. Those mandates which are of necessity carried over into regulations, cannot even begin to be accomplished without a satisfactory and certain method of identifying the participants in the industry. The brand designation and primary source regulations accomplish it in a very effective way.

In rejecting a recent challenge to N.J.S.A. 33:1-93.6, et seq., which prohibits discrimination in the sale of nationally advertised brands of alcoholic beverages, other than malt alcoholic beverages, by suppliers to wholesalers, the Supreme Court spoke of N.J.A.C. 13:2-33.1, the brand registration regulation we are considering. In dismissing an argument that the brand registration regulation was promulgated to allow a party to side-step the provisions of N.J.S.A. 33:1-93.6, et seq., the Court said, "...the true purpose of the registration requirement was expressed by the Director:

> 'The regulations of the Division of Alcoholic Beverage Control are an extension of the exercise of the full plenary powers of the State of New Jersey to regulate the sale and distribution of alcoholic

---

[8] N.J.S.A. 33:1-3 summarizes the statutes and regulations: "It shall be the duty of the commissioner (now 'director') to supervise the manufacture, distribution and sale of alcoholic beverages in such a manner as to promote temperance and eliminate the racketeer and bootlegger."

> beverages within its boundaries pursuant to the Twenty-first Amendment. In that regard Sub-chapters 25 and 33 of the regulations are designed to assist the State in identifying the distribution network of alcoholic beverages to insure tax integrity (See, N.J.A.C. 13:2-24.1, 14.6, 24.8, 25.1, et seq., 33.1 et seq., 39.1 and 39.2). The State simply wishes to know what products are being distributed within the State and by whom. The information is of great significance under circumstances such as are now present here, where a State has recently repealed a system of industry price maintenance and permitted a more pro-competitive market.'
>
> [In the Matter of the Brand Registration of Certain 'Western' Malt Beverages, A.B.C. Bulletin 2391, item 4, March 4, 1981.]"

Joseph H. Reinfeld, et al. v. Schieffelin & Co., etc., et al, _____ N.J. _____(1983).

The last major positive effect of the brand registration and primary source regulations is the promotion and enhancement of interbrand competition. The petitioners' primary argument has been that the regulations are anti-competitive and violative of antitrust laws. On the basis of all the evidence at the hearings, I can do nothing short of totally rejecting that argument, even though these proceedings were not intended as an antitrust proceeding. Since there are other valid reasons for the regulations, it is not necessary to even go into the antitrust or competition arguments (see, In the Matter of the Schedule of Rates for Barnert Memorial Hospital, supra), but the quantity of argument and evidence compels me to do so.

Petitioners have dwelt at length on territorial exclusivity of the distributorship designations by the brewers. I first note that the brand registration and primary source regulations do not compel any territorial arrangements; they merely require a registration of authorized wholesalers and, to give such registration meaning, prohibit sales by a non-registered wholesaler, unless such non-registered wholesaler has acquired the product from an authorized wholesaler. What the supplier (brewer, vintner or distiller) does by way of vertical restraints, and the reasonableness and legality of its practices, must still be examined under the "rule of reason" test, i.e., by judging its net competitive effect after a careful weighing and balancing process. Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). If those

vertical restrictions are non-price restrictions and they promote interbrand competition, which is a primary goal of antitrust laws, by permitting a producer to achieve certain efficiencies in product distribution, they will not be disturbed, even if intrabrand competition is not enhanced or is even curtailed. The bottom-line question is whether the consumer is worse-off. If not, a distribution arrangement should not be found to unreasonably restrain trade. See, Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742 (7th Cir. 1982).

In these proceedings there has been nothing to demonstrate any adverse effect on the consumer. Although petitioners' economist made an attempt to compare retail prices and to show that prices in areas where transshipping is presumed to take place is lower, there are so many other factors to be considered, and so many unknowns in the comparisons, that the figures are meaningless. Direct evidence tended to show that savings that might be realized from purchasing from a transshipper are not passed on to the consumer. On the other hand, the distribution system utilized in New Jersey under the brand registration regulations shows definite benefits to the consumer. Beer prices have kept below the inflationary average increase of other consumer goods. New products and a full-range of current products are readily available at fair prices. Products are properly warehoused in temperature-controlled settings to assure maximum quality and freshness. See also Del Rio Distributing, Inc. v. Adolph Coors Co., 589 F.2d 176 (5th Cir.), cert. den. 444 U.S. 840 (1979), which upheld a verdict that Coors' exclusive territorial restrictions were reasonable and there was ample evidence showing that the territories "were essential to maintaining quality control and service in the retail market" and resulted in "a long-term effect of making each distributorship stronger, better able to compete with other brands and provide better service." 589 F.2d at 179. Without the brand designation and primary source regulations, there would likewise be no incentive for suppliers to enter the New Jersey marketing area and risk capital investments. That would adversely affect the labor market. From the evidence produced, the benefits clearly outweigh any anti-competitive effects and demand the maintenance of the regulations.

The real antitrust test of the validity of the brand designation and primary source regulations is spelled out in Rice v. Norman Williams Co, supra, where the Court said, at 73 L.Ed. 2d 1049-1050:

> "A state regulatory scheme is not preempted by the federal antitrust laws simply because in a hypothetical situation a private party's compliance with the statute might cause him to violate the antitrust laws. A state statute is not preempted by the federal antitrust laws simply because the state scheme might have an anti-competitive effect. (Citations omitted).
>
> "A party may successfully enjoin enforcement of a state statute only if the statute on its face irreconcilably conflicts with federal antitrust policy...."

and where the Court said further, at 1051-1052:

> "California's designation statute merely enforces the distiller's decision to restrain intrabrand competition. It permits the distiller to designate which wholesalers may import the distiller's products into the State. It prevents an unauthorized wholesaler from obtaining the distiller's products from outside the distiller's established distribution chain. The designation statute does not require the distiller to impose vertical restraints of any kind; that is a matter for it to determine. The number of importers which may be designated by the distiller is not limited; the designated importer is not required to sell the imported brand to retailers within a specified area or from a specified location within the State."
>
> * * *
>
> "The manner in which a distiller utilizes the designation statute and the arrangements a distiller makes with its wholesalers will be subject to Sherman Act analysis under the rule of reason. There is no basis, however, for condemning the statute itself by force of the Sherman Act."

Thus, N.J.A.C. 13:2-33.1, 13:2-25.2(a) and 13:2-25.3(b) can also not be condemned as being per se violative of antitrust laws. The regulations themselves are valid. The conduct of parties utilizing the regulations can be questioned, but, as I have previously said, from the evidence at the June-July, 1983 hearings, there does not appear to be any violative conduct by suppliers or wholesalers either.

Petitioners have also argued that the brand registration and primary source regulations are discriminatory and violative of the Fifth and Fourteenth Amendments to the United States Constitution and Article I, Paragraphs 1 and 5, of the New Jersey Constitution. I do not agree. The Twenty-first Amendment to the United States Constitution is very broad and permits states to prescribe conditions which are not unreasonable and which subserve the policy of

confining the liquor traffic in order to minimize its evils. Ziffrin v. Reeves, 308 U.S. 132, 60 S. Ct. 163 (1939). See also California Retail Dealers Association v. Midcal Aluminum, Inc., 445 U.S. 97, 110 (1980), which says the Twenty-first Amendment gives the states "virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system." Similarly, the New Jersey Supreme Court has said, in Affiliated Distillers Brands Corp. v. Sills, supra, at 56 N.J. 256:

> "...It must be remembered that because of its inherent evils liquor has always been dealt with as a subject apart. Borough of Fanwood v. Rocco, 33 N.J. 404 (1960), Paul v. Gloucester County, 50 N.J.L. 585, 595 (E. & A. 1888). Its sale may be prohibited entirely or severely curtailed. Borough of Fanwood v. Rocco, supra 33 N.J. at 411. While the constitutional protections of equal protection and due process are applicable to actions arising in this area, these protections must be viewed in the light of the broad power of the Legislature to regulate the sale of intoxicating beverages. Indeed, that power has been called "practically limitless." Blanck v. Mayor and Council of Magnolia, 38 N.J. 484, 490 (1962); Meehan v. Excise Commissioners, 73 N.J.L. 382, 386 (Sup. Ct. 1906), aff'd 75 N.J.L. 557 (E. & A. 1908)."

In light of the broad-ranging power conferred by the Twenty-first Amendment, economic regulations promulgated in furtherance of a state's authority under it "merit only the mildest review under the Fourteenth Amendment." Craig v. Boren, 429 U.S. 190, 207 (1976). Only if there was proof that the State acted arbitrarily and irrationally in promulgating the brand registration and primary source regulations could they be held violative of the Constitution. See, Vance v. Bradley, 440 U.S. 93 (1979); Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981). There is no such proof.

Petitioners Seifert and Longwood also argue that the primary source regulation applicable to them, N.J.A.C. 13:2-25.3, should only be applied prospectively because a retroactive application would be unduly harsh and oppressive since those distributors had been transshipping prior to the promulgation of this regulation.[9] In asserting this position, the petitioners have correctly recognized

---

[9]Petitioner Iodice did not obtain his license until May 1982, well after the effective date of the brand registration and primary source regulations Therefore, this same argument would not apply to him.

that there is no presumption of prospective application of a regulation, but the law to be applied is that which is in effect at the time of rendering a decision, "unless doing so would result in manifest injustice...." Bradley v. Richmond School Board, 416 U.S. 696, 711 (1974).

Based on the evidence presented in the hearings, I do not find that there would be a manifest injustice to these petitioners. Although there is some evidence that they were transshipping prior to the effective date of the regulations in 1980, it must also be noted that both of these petitioners hold state beverage distributors' licenses, which confer a retail as well as a wholesale privilege. They are also both registered distributors for at least two brands of beer. Therefore, they are not rendered unable to distribute malt alcoholic beverages by the brand registration and primary source regulations. They can devote their efforts to developing the product lines which they are authorized to distribute rather than continuing, as the evidence indicates they have been doing, to attempt to selectively handle the larger and more popular brands to the detriment of the brands authorized to them.

It should also be noted that the privilege to sell the alcoholic beverages which is accorded to the petitioners by their licenses is exactly that - a privilege - and not something to which they have a vested right. That privilege must be exercised within the limitations imposed by the state, whether by statute or regulation, in order to achieve the goals of promotion of temperance and the stability of the industry. (See, Heir v. Degnan, supra).

Before concluding, I cannot fail to note that the existence of primary source regulations in the State of New Jersey is certainly not an arbitrary or uncommon happening. In fact, the action of New Jersey in this area is consonant with the action of approximately 80% of the states in which the sale of alcoholic beverages on the wholesale level is licensed to be carried on by private parties. Twenty-five other states, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Missouri, Nebraska, New Mexico, New York, Nevada, North Dakota, Rhode Island, South Carolina, South Dakota, Tennessee, Texas and Wisconsin, as well as the District of Columbia, have a primary source statute or regulation

at least akin to New Jersey's. The California statute, which is quite similar in effect, has previously been treated in the discussion of Rice v. Norman Williams Co., supra. The fact of the promulgation of such a statute regulation by the overwhelming majority of the "license states" is certainly an indication of the necessity and validity of such a regulation for the purposes previously discussed, and for the effective accomplishments of the goals of alcoholic beverage control.

In conclusion, I find N.J.A.C. 13:2-25.2(a), 13:2-25.3(b) and 13:2-33.1 are proper and reasonable regulations which serve several valid public purposes. I further find that the goals served by the regulations are necessary to the proper and effective regulation of the alcoholic beverage industry, and they should be retained and readopted upon expiration [pursuant to Executive Order 66 (1978)] in April, 1984. Additionally, I find that continuation of the stays of enforcement of the regulations as to the petitioners creates a situation which adversely affects the regulatory interests of the State and the stability of the alcoholic beverage industry, and creates the potential for tax violations and destructive trade practices which are not in the public interest. Both for these reasons, and in fairness to approximately 270 wholesalers and distributors complying with the regulations, the stays should be vacated. Since they were granted by the Appellate Division, however, the vacating of them must come from that Court.

Accordingly, on this 5th day of December, 1983, I confirm N.J.A.C. 13:2-33.1, 13:2-25.2(a), and 13:2-25.3(b), and I determine them to be in full force and effect. I further request that the Appellate Division vacate the stays of the enforcement of these regulations previously granted to the petitioners.

John F. Vassallo, Jr.

JOHN F. VASSALLO, JR.
DIRECTOR